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MONEY
TRADE AND INVESTMENT

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By

G. D. H. COLE

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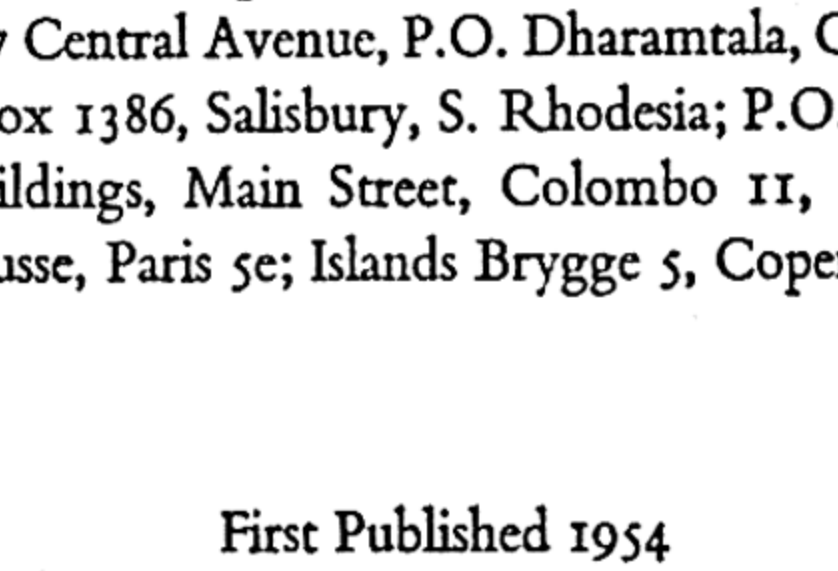

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PREFACE

THE present volume is based on a book entitled *Money, Its Present and Future* which I published in 1944 and in revised form in 1945 and 1947. During these years so many things were happening in the fields of monetary and international trade policy that both revisions were extensive; and by the time the third edition appeared the substance of the book had been considerably changed. I did not, however, produce a fourth edition when the third ran out of print, preferring to wait for a time in the hope of finding out how far my judgments, which differed considerably from those of many of my contemporaries, would be confirmed or controverted by the course of events. In most cases I have found them to be confirmed; and I have not seen reason for modifying many of them. I have, however, found it desirable to re-write the entire book yet again, in order to take full account of later events.

This has involved some lengthening, in order to deal with the balance of payments crises of the post-war period, with the working of Marshall Aid and other forms of American assistance, and with the events which led up to the formation of the European Payments Union and of the General Agreement on Trade and Tariffs, known as GATT.

The outcome is in effect a new book, though one in which the first part of the old one stands with only secondary changes. I have altered the title so as to make it more accurately descriptive of what it actually contains; for it deals with trade and investment almost as much as with money, though it does not attempt to formulate any general theory dealing with either. 'Money' stands first in the title, because it is from money that I set out, dealing with trade and investment only in as far as they are inseparably connected with monetary problems.

Although I have eliminated from the old version much that now seems out of date, I have thought it worthwhile to retain in a revised form the accounts of the rival British and American Plans which led up to the combined Plans evolved at Bretton Woods, for the reason that the discussion of these Plans brought up a number of important issues which were not settled at Bretton Woods, and have not so far been settled at all.

The book, in its revised form, will please some of the critics no

better than it did on its first appearance. There is a fashion nowadays of brushing aside the entire quantity theory of money as irrelevant to the real issues of monetary policy. That the old way of stating the quantity theory was open to grave objections I agree. I said so in the first edition, and I say so again. But it is one thing to admit that the quantity theory of money cannot be exactly applied in any situation, because there is never any way of saying exactly how much money there is, and quite another to dismiss as of no account all considerations of the quantity of money that is needed. Although we can never say positively how much money there is, we can get a pretty good notion of the extent to which access to money is being made harder or easier; and it remains both true and important that too great ease of supply can lead to perilous inflation and too great difficulty to no less perilous deflation. In this sense, the quantity theory of money does embody an important truth; and I still prefer my way of approaching the study of money from this angle to some newer approaches which appear to put all the emphasis on planned employment and the regulation of prices and hardly any on the monetary factors.

The earlier versions of this book had two largish appendices, both meant to help in clearing up certain popular fallacies. The first was devoted to a detailed refutation of the view, widely held among monetary heretics, that there is under the existing economic system a persistent tendency towards a deficiency of purchasing power, not only in periods of depression but even when the system is working relatively well. I have omitted this appendix, not because I wish to withdraw anything that I said in it, but simply because this particular monetary fallacy has ceased to be as widespread as it was during the inter-war period. In the circumstances of to-day, what I have written in Chapter V should be enough: if it is not, readers can probably find in libraries copies of the earlier editions, in which the matter is more fully discussed.

The second appendix, which I have also struck out, was connected with the same controversy. It was an attempt to distinguish the sense from the nonsense in the doctrines of certain monetary reformers of the inter-war period—notably Major Douglas. In this case too I have no wish to withdraw what I wrote; but, being short of space for giving an account of more recent controversies, I leave readers to look for it, if they want it, either in the earlier versions of this book or in its form as a separate pamphlet, entitled *Fifty Propositions about Money and Production.*

In the present re-writing my son, H. J. D. Cole, has given me a great deal of useful help. I have not accepted all his criticisms; but I have modified a number of statements and in some cases altered my method of treatment in the light of his comments. Once more I owe my secretary, Rosamund Broadley, much gratitude for her labours with a difficult manuscript. I am much indebted to my wife for help with the index.

G. D. H. COLE

OXFORD, *June* 1954.

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INTRODUCTION

MODERN wars of any magnitude always leave behind them a legacy of monetary problems. It was so after the Napoleonic Wars and, on a smaller scale, after the Franco-Prussian War: it was so, to a still greater extent, after the World War of 1914-1918; and it is so again to-day. Some of these difficulties are internal, and some international. Each country has to adjust its own internal monetary conditions after the expedients to which it has been driven in time of war; and it has also to be decided, either by the play of economic forces or by some sort of control or agreement, at what rates the currency of each country is to be exchangeable for other currencies. In 1945 and 1946, at Bretton Woods and in connection with the American Loan to Great Britain, highly important decisions about monetary policy were taken; and in Great Britain at any rate it was clearly proclaimed that internal policy was to rest on cheap money as a means to full employment. How far these decisions were compatible we shall have to enquire. Certainly they were not compatible under the old notions of sound monetary behaviour; for it used to be regarded as axiomatic that deflation, involving dear money and unemployment for a time, was the correct way of bringing an unbalanced exchange position back into balance.

These decisions about monetary policy, both internal and international, were bound to be of vital importance both to our own future prosperity and to that of the whole world. The experience of the period between the wars showed clearly that the world had not, even in 1939, made any real recovery from the monetary upsets which arose out of the first World War. To say this is not to contend that the world's economic troubles between 1918 and 1939 were mainly due to monetary disturbances or even to bad monetary policies. I do not think they were; but it is indisputable that monetary instability and mismanagement of the monetary factors made the inter-war economic crises more devastating than they would have been if the world's money affairs had been managed better. Money itself creates nothing: it is a lubricant of real economic processes of production and distribution of goods and services, a standard of value, and a means of storing claims to purchasing power. It is not creative; but when anything goes wrong with it the result can be to prevent useful things from being created, and to cause any amount

of economic loss and human distress. In getting our monetary arrangements right and sound, we shall not solve the numerous and difficult problems which confront us in the organization of our productive effort and in the distribution of what it yields. But, unless we get our monetary arrangements right, it is highly probable that everything else will go wrong.

The purpose of this book is both to provide a general account of money and of the working of various monetary systems, and to discuss what ought to be done in matters of monetary policy, internal and international, in order to maintain employment and in the interests of an expansion of international trade. My purpose is to do this, to the fullest possible extent, in language so simple that no ordinarily intelligent man or woman reader shall be prevented from understanding the problems involved by any obscurity in the language used. I cannot, of course, make easy those parts of the subject which are difficult in themselves; but I can at any rate hope to remove the obscurity from many matters which are not really difficult, but are made to appear so when they are clothed either in the complex terminology of professional economic theory or in the no less obscure jargon of money markets, stock exchanges, and other institutions of what is called 'The City'. I am writing primarily neither for professional economists nor for professional financiers, but for laymen—including politicians, whose knowledge of monetary matters is apt to be very sketchy indeed. The settlement after the first World War showed all too clearly the imperative need for a better understanding of such questions among political leaders as well as among ordinary men and women.

I am writing in this way, because the happiness and well-being of these ordinary people are at stake. Decisions about monetary policy, both internal and international, will have in future to be taken by Governments, just as much as decisions about tariffs, or house-building, or any other aspect of economic policy which affects the general welfare in a high degree. They will have to be taken by Governments; and, whatever their substance, they will purport to be decisions taken democratically in the public interest, with the assent of those who represent the people. There is, however, in this instance, a peculiarly high risk that this democratic character of the decisions arrived at may be merely a sham. For how can a democratic decision be taken about any matter which is not understood, at least by those representatives who are called on to make or to endorse it and by a considerable fraction of the intelligent public? I am not

suggesting that every voter can equip himself to form an intelligent judgment about the mechanisms of monetary policy, or about the policies to be furthered by these mechanisms. That would be altogether too much to expect, not only about money, but also about a great many other things that ought to be settled as democratically as possible. What I am combating is the view, widely held even among the most intelligent sections of the public, that there is about money some peculiarly esoteric quality which prevents it from being understood by ordinary men and women. I maintain, in opposition to this view, that money is not, for the most part, a particularly difficult subject, and that it is well within the reach of ordinary intelligent people—not indeed to master the intricacies of all its technical arrangements, which there is no need at all for them to attempt—but to arrive, on clearly presented evidence, freed from jargon, at sound views about the general lines of desirable monetary policy and, having done this, to exert pressure through public opinion to ensure that the right lines are followed, and the wrong avoided.

Ordinary intelligent people are apt to be frightened about monetary problems, because at the first approach everything seems to be topsy-turvy. Money is a means of buying other things; and the more money one has to give for them the dearer they are. It follows that, when goods are dear in terms of money, money is cheap in terms of goods. The fewer units of goods a sum of money will buy, the more units of money go to a unit of goods. Money and goods cannot both be cheap, in terms of each other, at the same time. But in a quite different sense money and goods can both be cheap together; for whereas, when we speak of the 'price of goods', we mean the amount of money needed to *buy* them, when we speak of the 'price of money' we ordinarily mean the rate of interest that must be paid for *borrowing* it over a period of time. Now, the rate of interest may be low at the same time as goods are cheap; and in this special sense money and goods may be cheap together, though they cannot be cheap simultaneously in terms of each other.

This confusing dualism depends on our habit of using the word 'money' in different senses. The money we keep in our pockets or in our current accounts in a bank, and use for buying things that we need or want, is not the same thing as the 'money' which is available in the 'money market' for those who wish to borrow it. As soon as it has been borrowed, this 'money-market money' is simply purchasing power, just like that other money which we use

for our current purchases. But until it has been borrowed it is something different—a potential source of purchasing power for which the owner can make a charge, in the form of interest, to anyone who borrows it from him. The cash we keep in our pockets, or locked up at home, or in our current accounts in the banks, does not ordinarily earn us any interest. It is simply a store of purchasing power, which we keep handy until we need to use it by transferring it to someone else in payment of taxes, or for goods or services—or by way of gift. But the money which is available in the 'money market' is money to be lent out at interest to various classes of borrowers who want a command over purchasing power in excess of what they have on hand in readily transferable, or 'liquid', form. The loan of such money has a price, which is the rate of interest which it can command; and this price can be high or low according to current conditions in the money market. It is not of necessity cheap when goods are dear, or dear when goods are cheap.

There is, however, nothing very terrifying about the fact that the word 'money' is used in different senses; for so are a number of words of which most people feel not in the least afraid. Most of the words we use have a variety of meanings according to the contexts in which we use them; and over a great many words difficulties arise because it is not easy to keep their several meanings distinct. This happens, not only because we are short of words and have to make many of our words do double, or triple, or quadruple service, but also because words, as Milton said of books, 'are not absolutely dead things, but do contain a potency of life in them to be as active as that soul was whose progeny they are; nay, they do preserve as in a vial the purest efficacy and extraction of that living intellect that bred them'. In effect, words, as we use them in everyday speech, trail along with them a multiplicity of associations, relevant and irrelevant to this or that particular purpose, in which a large part of their meaning to us, based on our past experience, is to be found; and we cannot rid them of this associative content and, as it were, pin them down to mean just this or that which we wish to signify without doing violence to their fuller meaning. The scientist, or anyone who aims at accuracy in discussion, must pin certain words down and make them mean, in the particular context of his discourse, as precisely as possible what for his immediate purpose he requires them to mean. This is the justification for the special terminologies adopted in the various sciences, which often use outlandish words precisely because they require words as

free as possible from associative content. Those writers whose business is with the affairs of everyday life are often placed, in this respect, in a peculiar difficulty. They cannot without extravagance avoid the use of everyday terms which are full of associative significance and are in many cases used in different senses in different connections. They have, however, to give to these words meanings more fixed and more precise than are given to them in ordinary speech; and, in doing so, they often appear to the layman to be talking nonsense and to be doing violence to the common meaning of ordinary words. Economists are especially liable to this source of misunderstanding, because they are trying to write precisely about things which are continually talked of in unprecise and highly coloured terms. In writing of money the difficulty is particularly acute, because in addition to the layman's talk there are the special jargons of the market-place, the stock exchange, the 'City', and the financial newspapers: so that many words, including 'money' itself, have a host of meanings, and obstinately resist being pinned down to serve only a single use.* I think myself that many of the consequent misunderstandings are largely of the economists' own making; for they fail themselves, despite their resolutions, to stick consistently to the single sense in which they lay down that a particular word is to be exclusively employed. How, indeed, can they help failing, unless they are to give up using their native tongues, or to invent new words to take the places of those they have appropriated to a single specialized scientific use? It would be better if they would invent new words for their own specialized senses, instead of appropriating and impaling the words used currently by the ordinary man. But, even if they were to do this, they would need translators, who would, even at a sacrifice of accuracy, put their writings back into language intelligible by ordinary, non-expert readers. Accurately delimited words, meaning unambiguously one thing and one thing only, are of great convenience and even necessity to the expert, both in his thinking and in his communion with his own kind. For the rapier-work of economic and financial discussion they are invaluable; but the ideas which are thus expressed should, if they are relevant to men's everyday affairs, be capable of translation into non-technical language without losing their main value. This book, in which I eschew, wherever I can, all technical language, either of the academic study

* To say nothing of the additional difficulty that there are wide differences between British and American monetary terminology.

or of the market-place, is an essay in such translation, or retranslation, written in the belief that monetary policy is too important for the welfare of the whole people to be left for settlement by the experts, without appeal to the commonsense judgment of the ordinary man.

The first point at which monetary policy plainly affects the interests of the ordinary man is that of employment. Most economists are now prepared to agree that it is practicable for a country which sets out to maintain a condition of 'full employment' to achieve its aim only if its monetary policy is rightly adjusted to the maintenance of demand at the required level. In other words, there must be a sufficient amount of purchasing power in active circulation to keep the producers and distributors of goods and services busy and not to induce employers to curtail the volume of business activity for fear of incurring losses. We shall discuss later what this involves in practice, and also what happens if the supply of purchasing power is increased beyond what is necessary to maintain 'full employment'. For the moment, we need only observe that, although in theory *any* quantity of money can be sufficient to achieve the distribution of any quantity of goods and services, provided prices can be adjusted without hindrance, in practice prices never can be so adjusted. Changes in the supply of money do not react either equally or equitably on all prices: they distort price-relations and in doing so set up all sorts of secondary reactions, some of which may be for good, but many of which will certainly be, at any rate in the short run, inconvenient and unjust. It may be necessary, for sufficient reasons, to put up with these inconveniences and injustices when we think the good outweighs them; and we may reach the conclusion that those economists who, in order to avoid them, propose to stabilize the supply of money once and for all would, if they had their way, lead us into even greater injustices and inconveniences. But it is plainly true that we should, as far as we can without causing greater evils, try to immunize our economic systems from the effects of unnecessary changes in the supply of money and to offset the consequences of changes in supply which are not responses to any real change in the need for means of payment. Monetary stability is in itself a good, and worth pursuing, provided we do not make the mistake either of pursuing it as the only good or of confusing it with a rigidity of supply which may in fact induce not stability at a satisfactory level of economic activity, but persistent depression.

I can safely begin by asserting that there ought to be enough

money, of various sorts, available at all times to make possible, in the light of the existing economic structure and conditions, the maintenance of 'full employment'. In saying this, I am not by any means putting forward employment as an end in itself. Employment, including of course the work of employers and independent workers as well as that of 'employed persons' in the narrower sense, is not an end but a means. It is a means to getting goods produced and distributed and services rendered; and it is desirable up to, and only up to, the point at which the community elects for more leisure rather than for more goods and services produced by human effort. 'Full employment' means, not that everybody ought to be at work up to the very limits of his capacity, but employment as nearly as possible up to an *optimum* point beyond which leisure is preferable to more goods and services. This is the amount of employment which, having made the limits and the meaning clear, we can safely postulate as desirable; and it is this amount of employment that there ought always to be enough money available to maintain.

There are, I know, still some people who cavil at this objective and maintain that an economy cannot work well unless there are, at any rate for some of the time, too few jobs to go round. Some unemployment, over and above the irreducible minimum which comes of people changing jobs and of the frictions involved in fitting people into the jobs that are available, is regarded by these objectors as necessary because, they say, without it too many workers will go slack and discipline will collapse. Those who hold this opinion are nowadays often reluctant to express it in public, knowing that it may be ill-received; but it is undoubtedly held in private by many business men, managers and supervisors, and by some economists. On this view, the workers, or many of them, need to be kept on their toes by fear of losing their jobs; and those who hold it usually speak in these days of 'over-full' employment as existing where almost anyone who falls out of work, and is capable of it, can fairly easily find another job. As against this view, advocates of the 'Welfare State' point to the fact that in the countries in which full employment existed after 1945 output, far from falling, increased rapidly; and, apart from this, they argue that a democratic society ought to be able to devise better methods of inducing its members to do a fair day's work than that of threatening their families with the loss of their means of life. Something approaching full employment has in effect come to be recognized as an essential part of the policy of the 'Welfare State', at any rate in Great Britain; and it

follows that the right national monetary policy must be one that will allow full employment to be maintained, as far as its maintenance is practicable by national means.

The maintenance of full employment was also recognized as an international objective in the draft Charter of the abortive International Trade Organization, designed as one of the 'specialized agencies' of the United Nations; but, as we shall see, the I.T.O. foundered before it was fully launched because the Americans withdrew their support. A further attempt to get full employment accepted as an international responsibility was made in the United Nations Experts' Report on *National and International Measures for Full Employment*, published in 1949; and in this report an attempt was made to work out the measures which the various Governments would need to take in order to make such a policy effective. But this plan, too, failed to secure the needed support—especially that of the Americans, on whom a large share of the responsibility would necessarily have rested.

Yet the aim of full employment obviously needs to be pursued by international as well as by national means. It applies as an objective to each country, and accordingly it applies to all, and should be recognized in any international monetary arrangements that may be made either on a world-wide scale, or between particular countries or groups of countries. All such arrangements should be of a nature to facilitate the maintenance of full employment both in the home territories of the countries concerned and over all the world. It is a further obvious truth that success in maintaining full employment in one country is a contribution towards maintaining it in others, unless this success is achieved by highly autarkic methods. Full employment in a country implies a high level of consumption as well as of production; and unless the country is very self-contained this in turn involves that it will be a good customer of other countries for materials needed in its industries and probably also for a wide range of consumers' goods. The successful pursuance in one country of a policy of full employment therefore, in most cases, makes it easier for other countries to pursue similar policies; and it should clearly be a prime object of international policy to bind countries together for a common pursuit of full employment on conditions which will enable them to help instead of hampering one another's efforts.

It is, of course, fully possible for certain countries to attempt to achieve full employment for themselves either by isolating them-

selves from others or by attracting employment to themselves at other countries' expense. When a country isolates itself to a large extent (no advanced country could, of course, do so entirely), reducing both its imports and its exports to the lowest possible balancing point, the effect is to reduce the total level of international trade and to rob the world's consumers, at least potentially, of some of the advantages of international specialization. The adverse effects of such a policy in a single country on the rest of the world need not, however, be at all serious, unless the self-isolating country has exclusive possession of any important substances which other countries badly need. The rest of the world can adjust itself to a régime of mutual trading such as would arise if the self-isolating country were wiped right off the map. Difficulties of transition there would be, and they might be serious and prolonged if the country in question had previously played an important part in world trade; but when the adjustments had been made, no great harm need have been done to the rest of the world.

This, however, is not the form which in the past the attempt to build up policies of national *autarkie* has usually assumed. *Autarkie* has not meant doing as far as possible without both imports and exports. It has meant (*a*) trying to make the country which practises it as independent as possible of outside supplies essential to self-sufficiency in time of war, and (*b*) trying to push exports by all possible means, while restricting imports of all sorts that will not help towards the achievement of wartime self-sufficiency—i.e. machinery needed for essential industries and stocks of scarce materials are brought in, but imports of other goods are discouraged or prohibited. The 'guns instead of butter' policy is applied much more drastically to foreign trade than to home production: the autarkic country tries to export 'butter' in order to import 'guns' —taking 'guns' to mean anything that will strengthen its self-sufficiency under conditions of war blockade.

Such a policy exerts a much more unfavourable effect on the rest of the world than a policy of sheer isolation. Its consequences are especially bad where, in face of the impracticability of complete self-sufficiency, it is used as an agent of imperialistic expansion with the object of inducing weaker neighbouring countries to become economic satellites of the autarkic State. This was Germany's policy from 1933 to 1939—a determined endeavour to reduce countries which, in the event of war, the Nazis could hope to overrun and to bring within their war frontiers to the position of economic

satellites, producing such goods as could not be produced in Germany up to the point required to ensure self-sufficiency in time of war. This policy, to the extent to which it was successful, distorted the structure of European production. That it did to a great extent succeed was due to the fact that it was launched at a time when the world as a whole, far from following a concerted policy of full employment, was haunted by depression and altogether lacking in any common policy for expansion by mutual help. The countries which the Nazis largely succeeded in dominating fell victims to German imperialism because they were riddled with unemployment and distress and could find nowhere except in Germany markets for the products which they needed to sell abroad in order to meet even the minimum import requirements of their home markets. It was preferable to sell to the Germans what the Germans wanted, even under highly disadvantageous conditions, to not being able to sell at all; and it was accordingly possible for the Nazis to impose on these needy sellers the most stringent conditions regulating both what they were to produce and what they were to receive in exchange. Even if they could neither produce what they were best fitted to produce nor get for it what they most wanted to buy, it was better to get something than nothing—and the rest of the world was offering practically nothing that the needy countries could find means of paying for.

It would take me much too far afield to attempt to describe the elaborate techniques which the Nazis built up for applying this carefully-thought-out policy of economic imperialist penetration. Its relevance to the questions discussed in this book is that monetary manipulation played in it a vitally influential part. The essence of the German method lay in the creation of a series of systems of bilateral trading and monetary exchange. The Nazis paid for what they bought, not in free currency which the sellers could spend as and where they pleased, but in one form or another of 'blocked' or earmarked German money which could be spent only in Germany, and sometimes only on certain specified German goods. The favourite instrument was that of the 'clearing' account. In the simplest form this meant that the German importer paid for what he imported not to the seller in the seller's currency, but in German marks, into an account kept at the German Central Bank. Similarly, the purchaser of goods from Germany paid, not to the German seller, but into an account in his own Central Bank. The German exporter was then paid, by the German Bank, out of the sums lying

in its account, and the exporter of goods to Germany got his payment out of the account held by the Bank of his own country. If the accounts balanced, everybody got paid: if they did not, that is, if one country had bought more than it had sold and the other sold more than it had bought, some of the sellers in the country which had sold the more had to wait for their money, and a sum lay unused in the account in the other country after all its sellers had been paid.

The Nazis showed themselves adept at manipulating this system of bilateral clearing for their own advantage. They manipulated the rates of exchange between the *reichsmark* and the currencies of the countries with which they were dealing; they manipulated surpluses and deficits in particular clearing accounts as suited them from time to time: they exacted the products they wanted from other countries, and forced other countries to buy just what it suited them best to sell. This could not have been done if there had been alternative markets open to the countries affected, as there would have been if the world as a whole had been prosperous and well-employed. The Nazis were able to exploit the prevailing world conditions of mass-unemployment and under-consumption, and in doing so to make themselves strong, and the others weak, for the war for which they were getting ready from the first. The Nazi policy would have broken down, if indeed it could ever have been started at all, in a world actively pursuing both national and international policies of full employment.

Observe, pray, that the Nazi policy of *autarkie* did not imply either a diminution in the volume of German foreign trade or a determination on the part of the Germans to have in the long run what is called a 'favourable balance of trade'—that is, to export more than they imported. The aim of the Nazis was not to do less foreign trade, but to make their foreign trade serve their imperialist and warlike ends. They did not want, except temporarily, for the purpose of building up claims to future imports, to dump German goods abroad without getting paid for them with imports, as some other countries have sometimes seemed anxious to do. They wanted to be able to import as much as they could of the things that would help to make them strong for war, and to export as much as they could spare in order to be able to buy these things; and they wanted to shift the 'terms of trade' in their favour, by giving as few German goods as possible in exchange for what they wished to import. The gravamen of the charge against the Nazis is neither that they set out

to diminish world trade nor that they set out to 'dump' German goods on the rest of the world: it is that their policy of *autarkie* deliberately distorted the channels and the nature of the world's commerce to the one-sided advantage of Germany—or rather to what the Nazis held to be its advantage.

Nor is it true that the Japanese, who were following in certain respects a similar policy, set out to sell more than they bought; for the Japanese wanted heavy imports in order to build up their war potential, and the active pushing of Japanese exports was a means to buying imports and not to building up a 'favourable balance of trade'. Japan was not strongly enough placed to push bilateral bargaining to the same extent as Germany, or to make use of the same devices of monetary manipulation. The Japanese had to concentrate mainly on pushing their exports by every means in their power; but they pushed their sales in order to buy. They were good customers to other countries, as well as competitors. In a purely commercial sense, leaving out their imperialist objectives, the world had no cause to complain of them, however much their competition adversely affected certain old-established industries in other countries, including Great Britain.

It is, indeed, probable that the imperialist economic policies of Germany and Japan in the 'thirties, far from lowering the total of world trade, positively increased it. If they had not set out to buy all they could that would increase their aggressive power, who else would have been in the market as a buyer? Nobody denies that re-armament, like any other form of public investment, is good for employment in the country which practises it: so why should we attempt to deny that, in the 'thirties, the countries which were busily arming for world war helped to raise the level of world economic activity and of world trade at a time when more pacific countries were squealing impotently in face of mass-unemployment and its correlative, reduced purchasing power both at home and abroad?

It is true that Germany, unlike Japan, had over the five pre-war years as a whole an export surplus. Over those five years German exports averaged 4,871 million *reichsmarks* and German imports 4,745 million. But already in 1938 the position of the previous years had been reversed. Exports were 5,249 million and imports 5,443. The phase of intensive importation in readiness for war had set in.

The 'discriminatory' trade and monetary policies practised by Nazi Germany in the 1930s, largely under the influence of the ingenious Dr. Schacht, were highly unpopular with other advanced

countries—including the United States. Indeed, a good deal of the passionate insistence on 'no discrimination' since 1945 has been due to a sharp reaction against Schachtian practices and to a confusion of economic planning in relation to international trade with totalitarian and economic imperialism. Despite this reaction, countries less strongly placed than the United States have been forced, in sheer self-defence, to adopt discriminative measures in respect of imports for the protection of their balances of payments; and the United States has had to acquiesce, reluctantly, in their doing so to a limited extent. But there has been a strong tendency to argue that, in respect of imports, all discrimination is wrong in principle, and should be tolerated only as a temporary exception to a general rule. Such an attitude, as I shall try to show later, has the effect of banning practices which could expand international trade, as well as other practices that would restrict it.*

Most of us are now agreed that we want both full employment in each country and a high level of trade between countries. We can have these things together only on certain conditions. Full employment within a country requires a system of economic planning, at any rate to the extent of requiring the State to assume responsibility for ensuring a high level of economic development and an abolition of restrictive practices designed to uphold prices at the expense of diminished output. Such planning can clearly take, at any rate in some countries, a strongly nationalistic line, aiming at the largest practicable measure of self-sufficiency, not mainly as a means to war preparation, but rather in the hope of insulating the national economy from the effects of depression and dislocation in the rest of the world. It is, indeed, bound to follow this line to a certain extent if only one country is pursuing a full employment policy, or at most a few, while most countries, or the most powerful, are continuing to operate under conditions which allow cyclical fluctuations and restrictive monopolies to exert their devastating effects. Clearly, what is wanted is not a series of quite independent national policies, carried out in the spirit of isolation, but a concerted international policy, covering as many countries as possible and designed to harmonize their national policies in such a way as to encourage a high level of mutual exchange and of collaboration in the economic development of the more backward areas.

Indeed, national planning in individual countries involves international planning, unless it is to be perverted into isolationism.

* See pages 374 ff.

Laissez-faire in international commerce and finance was the natural concomitant of internal policies of *laissez-faire*. As soon as countries give up letting their internal economic affairs manage themselves with a minimum of state intervention, and take instead to national planning for full employment, it becomes indispensable to extend planning to the international field, and to devise an international framework for the co-ordination of national plans. The old system, under which the international framework consisted mainly of a monetary arrangement whereby the relative values of national currencies were fixed by common adherence to the gold standard, will no longer serve; for the postulate of that system was that the effective units in international economic relations were not States, but private traders who happened to live in different countries and needed means of exchanging goods and money without bringing in their respective Governments. Planned economy on a national basis makes it impossible to allow private traders to act across national frontiers in ways which may upset the national plans of their several States. It implies regulation of international economic relations, on both the commercial and the monetary plane.

This book is largely an analysis of the necessary implications of national planning for full employment as they appear in the field of money. It has to begin with an elementary exposition of the main monetary concepts and problems, because these are in general so little understood. But it is a 'textbook' only to the extent to which it must be a 'textbook' in order to equip its readers with the necessary knowledge of elementary monetary facts. Without this knowledge, they cannot possibly form an intelligent judgment about the questions which they, and their representatives in Parliament and in international negotiations about monetary and trading policies, have to decide.

The point which I wish mainly to stress in this book is that no country can pursue with success a policy designed to ensure full employment of its labour and productive resources unless it is in a position to control the conditions of its internal monetary supply. This control is imperative, because the internal structure of costs and prices is not perfectly malleable, so that an enforced expansion or contraction of the means of payment is bound to distort the relations between costs and receipts in different branches of the economy and to upset the relative incomes of different classes and groups. Countries which are pursuing policies of full employment cannot afford to accept such distortions at the call of forces which

are exterior to their domestic economic conditions and requirements. They must reserve their freedom to adapt their monetary policies to their own needs, not without regard to the repercussions of what they do on other countries, but so as not to allow their own actions to be determined for them by forces over which they have no control. The right compromise may well be to establish an international currency unit in terms of which the values of all national currencies can be measured, without any unalterable fixing of these values. Such a system might give each country a new sense of responsibility in the management of its monetary affairs, without tying it down to a fixed international standard that might disastrously fail to correspond to the requirements of its internal economic policy.

I am conscious that these may seem dark sayings to many of my readers. But I cannot illuminate them further at the beginning of this book. Their meaning and their relevance will, I hope, emerge plainly before I have done. Money is an instrument for effecting exchanges, both within countries and between countries; and our problem is to find ways and means whereby it may serve both these purposes to the satisfaction of the peoples of the world. Important as international trade is, we must never forget that many more exchanges take place within than between countries, and that accordingly the first requirement for a satisfactory monetary system is that it shall serve fairly and adequately as a medium for internal transactions. It would be folly to adopt any system which simplified international exchanges only at the cost of making internal exchanges more difficult or more unjust. Our object, in settling the issues of monetary policy, must be to strike a reasonable balance between the needs of the domestic market and those of international trade and investment, and as far as possible to meet the demands of both. A stable international medium of exchange, combined with a freedom, subject to consultation, to adjust national currency values in relation to it, may prove to be the method open to the peoples of making the best of both worlds.

I

WHAT IS MONEY?

WHAT is 'money'? Before I attempt a definition, I had better begin with an enumeration of some of the kinds of 'money' of which any definition will have to take account. There is, first and most obviously, the 'money' we are accustomed to carry about in our pockets and to use in meeting the everyday expenses of living. This is also the 'money' in which wages—but not usually the higher incomes—are paid: so that wage-earners habitually receive their 'money' in the same form as they spend it, whereas the recipients of other incomes for the most part receive them in one form and spend at any rate part of them in another.

This first kind of 'money' is *cash*. It takes two forms—*coins* and *notes*. Coins are issued by the State, from the State Mint, which has a monopoly of coinage; and coinage has been for a very long time in most countries a government monopoly. Notes, on the other hand, are issued in most countries not directly by the State but on its behalf by some sort of Central Bank. In most countries the Central Bank is publicly owned, and its governing body is appointed by the Government. But this is not the position everywhere; and, even where it is, the governing body of the Bank may be allowed a large freedom in shaping its policy. In Great Britain, up to 1946, the Central Bank—the Bank of England—was a privately owned corporation: its directors and its powerful Governor were appointed by its shareholders, who were mostly bankers of one sort or another; and, except in wartime, it was in a position to follow to a considerable extent a policy of its own. In practice there was usually close consultation between the Bank of England and the Treasury; and the Treasury's power over the Bank had been increased by the institution of an Exchange Equalization Fund under Treasury control. But, even so, the Bank was an independent body, in a position to influence the Government and not merely taking orders from it. The Bank of France was formerly in much the same position as the Bank of England, but lost some of its independence in the 1930s. The German *Reichsbank* was more completely state-controlled. In the United States, instead of one Central Bank there were twelve, linked together by a Federal Reserve Board whose directors were appointed by the Government. The position varied from country to

country; but almost everywhere the function of issuing notes was in the hands of the Central Bank, and the Bank's powers of note-issue were regulated by statute. These statutes limited and defined the power of note-issue, but did not entirely remove the Central Banks' discretion in relation to it. In some countries, other banks, besides the Central Bank, have limited powers to issue notes. Thus, in Great Britain the Scottish banks also issue a small number of notes of their own; and at one time a great many banks in England used to issue notes. But except in Scotland the issue of notes in Great Britain has now been concentrated in the hands of the Bank of England; and the separate Scottish issues are on too small a scale to matter.

In the first World War the Government itself issued notes, known as 'Treasury Notes'; and these remained in circulation for some time after the war was over. These Treasury Notes were entirely £1 and 10/- notes; and all notes of larger denominations continued to be issued by the Bank of England. The small notes had to be issued, partly to replace gold coin, which was withdrawn from circulation at the outbreak of war, and partly to meet the increasing demands for cash as incomes and prices rose during the war. It seemed the natural course for the Treasury, rather than the Bank of England,* to issue them, because they were needed at first mainly to replace gold sovereigns and half-sovereigns previously issued from the Mint. It was an important decision of policy when, in 1928, it was decided to place the entire note issue in the hands of the Bank, leaving to the Mint only the manufacture of silver-alloy and copper coins—the small change of everyday business. The object was to have, in effect, one body responsible for the entire supply of cash; for the demand for silver and copper coins has no independent importance. In effect, such coins are also put into circulation through the Bank of England, which procures from the Mint and passes over to the commercial banks such supplies of them as it needs to serve as small change for the ultimate customers, the public.

Coins are made of metal—nowadays usually of silver or copper alloyed with other metals. Before 1914 coins used also to be made of gold; and the gold sovereign actually contained a weight of gold worth 20/-. The Bank of England was always prepared to buy gold by giving sovereigns of equivalent weight and fineness in exchange. In most other countries in which gold coins circulated these conditions did not hold good. Most States made a charge, called *seigniorage*, to meet the cost of coining, and some charged enough to

* Now public property, but then in form a private corporation.

yield a profit: so that the gold coins they issued were not quite worth intrinsically the sums for which they passed current. It was because no such charge was made that the British sovereign was acceptable almost anywhere in the world.

Nowadays gold coins have gone out of circulation everywhere; and only silver and base metals remain. The coins that circulate to-day do not purport to be worth intrinsically the sums, or anything like the sums, for which they pass current. They are not solid money, worth its face value, but *token money*, owing their value as money to the fiat of the Government which issues them. There used to be in some countries silver coins which were worth, or nearly worth, as metal the sums inscribed upon them. But these coins too have ceased to circulate; and our own 'silver' coins are now made not of actual silver but of cupro-nickel instead. There has been a world-wide tendency to reduce the intrinsic value put into coins for use as money. It is now generally recognized that if a coin is not worth, as metal, the full amount for which it passes current as money, it does not matter in the least how little it is intrinsically worth. What does matter is that it shall be as difficult as possible to counterfeit; for obviously the temptation to counterfeit money increases as the difference between its intrinsic and its monetary value is widened.

Notes are made, not of metal, but of paper. There is no question of their having any substantial intrinsic value. They are, indeed, usually made of carefully watermarked paper of high quality, and much care is taken with the printing, which is a very highly specialized trade. These precautions are necessary both to produce paper money which will stand wear-and-tear, and to guard against forgery, which offers the prospect of very large gains where it can be successfully practised. The bankers have improved the art of detecting forged notes to a very high level of perfection; and in this country forgery is now uncommon, though it has not disappeared. In Great Britain all paper notes are in numbered series; and no note is issued for a value less than 10/-. In some other countries very much smaller notes are in circulation, and the supply of token metallic money is accordingly reduced. There is no vital difference, from the standpoint of monetary theory, between token coins made of metal and token notes made of paper. They serve the same purposes; and both owe their monetary value to the fiat of the State, which either issues them itself, or authorizes a bank or banks to issue them. The difference between state issues and bank issues is important in some

connections; and we may have to come back to it. But for our present purpose we can group token coins and token notes together as the kinds of money which the ordinary man or woman receives in wages and everybody uses for making small day-to-day payments.

Wealthier persons, and some who are no more wealthy than wage-earners, receive their incomes, not in cash, but by *cheque*. If they have bank accounts of their own, they usually pay these cheques as they receive them into their banks, and meet their expenses partly with cash which they draw out of the banks by presenting cheques payable to 'self', and partly by writing cheques payable to their creditors. If they have no bank accounts, they get someone—often a tradesman—to change their cheques into cash, and thereafter meet their expenses by paying out cash. Most large payments are made nowadays by cheque: at least this is so in Great Britain, whereas notes and bills—to which we shall come presently—are made more use of in many countries where the use of cheques is less well established, or less widely spread. In Great Britain, most middle-class households settle their larger tradesmen's accounts by cheque, pay their rents, insurance premiums, taxes, and other large outgoings by cheque, and in effect cause their bank to keep for them a considerable part of their personal accounts. Similarly, most considerable business transactions are settled by cheque. Retail traders, who receive money in cash across their counters, pay most of it into the banks, retaining only till-money, and settle their own accounts with wholesalers mainly by cheque. Thus, there is a regular flow of cash out of the banks late in the week, when most wages are paid, and back into the banks throughout the week, as traders pay it in. In working-class areas, this regularly circulating cash covers a much higher proportion of total expenditure than in richer areas, where more of the current expenditure is met by the use of cheques.

Coins and notes are 'money'; but cheques are not 'money'. The essence of money is that it can be passed from hand to hand in one act of circulation after another. A cheque, as against this, normally circulates only once. It is usually made out to a particular person, who has to write his name on the back of it as a receipt for the money. The person to whom it is made out 'endorses' and presents it, and is paid; and the cheque is thereupon cancelled and is returned in due course by the bank to the person who wrote it out. A cheque can, no doubt, circulate more than once. I can persuade somebody to give me money for a cheque made out to me, when I have signed it on the back; and this person can even

pass it on to someone else before it is paid into a bank. But such circulation is unusual: most cheques are paid straight in to a bank by the person to whom they are made out. For an intermediate person to accept a cheque is an act of grace, and not of right. The value of a cheque depends on the person who wrote it out having sufficient credit with his bank for the bank to honour it: a cheque does not, like a bank-note, carry with it the bank's promise to pay. If the person who wrote, or 'drew', it has not sufficient credit with his bank, the bank will refuse to honour the cheque, and will mark it 'R.D.'—'refer to drawer'—or, sometimes, 'No account'. A cheque is simply some person's private promise to pay: its value depends on the drawer's ability to meet his obligation.

There are actually two sorts of cheque—'order' cheques and 'bearer' cheques. An 'order' cheque is an order made out by a person to his bank to pay a named sum to a specified person: a 'bearer' cheque is a similar order to pay a sum to a specified person or to 'bearer'—that is, to anybody who presents it at the bank. In everyday affairs, 'order' cheques are by far the more usual, because they are safer. If a 'bearer' cheque gets lost, anyone can present it to the bank and get cash for it, unless the drawer, conscious of his loss, has already ordered his bank to refuse payment; whereas an 'order' cheque, being an order to pay cash to a named person, cannot be honoured without that person's signature on the back.

Most cheques are both made payable to the 'order' of a particular person, and also 'crossed'. A 'crossed' cheque has two lines drawn diagonally across its face, and these lines mean that it cannot be cashed across the counter of the bank on which it is drawn, but must be paid into the account of someone who has an account at the same or at another bank. The 'crossing' may be either general or particular. The person who draws the cheque may write between the diagonal lines the name of the bank or of the specific account into which the cheque is to be paid. Thus, cheques drawn in payment of income tax are habitually crossed with the words 'Commissioners of Inland Revenue Account'. 'Crossing' is an additional safeguard that a cheque will not be used to get cash paid into the wrong hands; and specific crossing is a further safeguard.

Cheques, then, are not 'money', but merely orders on a bank to transfer money, or command over money, from one person to another. They do not circulate indefinitely, but in most cases perform their function in a single act of circulation; and, as most cheques are not cashed directly, but are paid into a bank account, the

TABLE I

World Output of Gold, 1913-1953

excluding China and (from 1932) Russia

Thousands of Kilograms

	Total	*S. Africa*	*Canada*	*U.S.A.*	*Australia*	*Russia (estd.)*
1913	728	274	25	134	69	40
1920	505	259	24	77	30	2
1921	494	253	29	75	24	1
1922	472	218	39	71	23	5
1923	541	285	38	75	22	8
1924	545	298	47	76	21	20
1925	540	299	54	72	17	25
1926	544	310	55	69	16	25
1927	547	315	58	66	16	22
1928	552	322	59	67	14	25
1929	550	324	60	64	13	29
1930	565	333	65	67	15	38
1931	599	338	84	69	19	42
1932	690	360	95	69	22	(54)
1933	699	343	92	71	26	(77)
1934	718	326	93	85	28	—
1935	766	335	102	98	28	(138)
1936	849	353	117	117	37	(165)
1937	919	365	128	128	43	(160)
1938	993	378	147	132	50	—
1939	1,057	399	159	144	51	—
1940	1,123	437	166	151	51	—
1941	1,108	448	167	150	47	—
1942	973	439	151	111	36	—
1943	769	398	114	43	23	—
1944	685	382	91	32	20	—
1945	654	380	84	28	20	—
1946	668	371	89	45	26	—
1947	681	348	96	67	29	—
1948	697	360	110	63	28	—
1949	726	364	128	60	28	—
1950	750	363	138	71	27	—
1951	733	358	136	59	27	—
1952	826	367	139	60	30	—
1953 (prov.)	824	371	131	62	33	—

common use of cheques is to transfer command of bank deposits from one person to another.

If, however, cheques are not 'money', what of the bank deposits they are used to transfer? A person who has a bank account keeps a certain amount of purchasing power about him, or locked up at home, in the form of cash. But the amount so kept is usually small. Most of the purchasing power that accrues to him he probably keeps in the form of a deposit at his bank, until he decides to spend it. He can write a cheque against any sum standing to his credit in the books of his bank whenever he wishes to do so. Such a credit is, for most purposes, fully as good as cash, provided only that he can reasonably rely on the bank's ability to pay; and it is much more convenient to keep large sums in the form of bank deposits than to hold them in coin or notes. Where fears arise about the solvency of banks, as they did in the United States in the crisis of 1932-33, many persons will withdraw money from the banks in cash, and keep it about them or in safe deposits. But normally, in the modern world, banks are regarded as safe deposits for supplies of purchasing power; and the convenience of holding money in the form of bank deposits causes most of the bank-using classes to hold most of their supply of ready money in this form.

Bank deposits are of two kinds—*current* accounts and *deposit* accounts. Current accounts consist of sums which can be drawn upon at any time without notice. The banks hold such sums on behalf of the owners, but, save in certain very special cases, pay no interest on them. Deposit accounts, in the narrower sense—sometimes called 'time-deposits'—consist of sums deposited on the condition that they will not be withdrawn without a certain number of days' notice. On such accounts the banks pay interest, usually at a low rate. In practice, deposit accounts can be drawn upon without notice, because a banker will nearly always be ready to advance a sum at once to anyone who has it on time-deposit. In general, sums standing in current accounts are those which the owners think they may want to use almost at once, or at any moment; whereas time-deposits are sums which the owners expect to leave in the bank for an appreciable period. The difference, however, is by no means hard-and-fast; and some large concerns, which have big fluctuating deposits at the bank, are in a position to arrange with it to receive interest on their current accounts without the formality of converting them into time-deposits.

Bank deposits *are* money, though cheques are not. Bank deposits

have exactly the same qualities as coins or notes, in that they can be transferred indefinitely from hand to hand, in payment for goods or services or in settlement of debts or obligations of any sort. A bank-note is a bank's promise to pay, embodied in a transferable bit of paper: a bank deposit is a similar promise to pay, inscribed in the bank's books, and drawn upon by cheque as required.

Bank deposits are, in the world of to-day, much the most important element in the supply of money. They would become even more important if, as has sometimes been proposed, wages were paid by cheque instead of in coins and notes. The reason why this is not done is that it would involve too much trouble. Either the wage-earners would present their cheques at the bank, and change them for cash—in which event there would be no advantage over payment in cash at the works—or they would settle their own bills largely by cheque. As their transactions are mostly small, the handling of these cheques by the banks would involve much book-keeping, for which the banks would have to make a charge in order to cover their costs. The wage-earners would thus suffer a deduction from their earnings which they can avoid by receiving and paying out their incomes in cash, and thus acting as their own book-keepers. This is not to say that no wage-earners keep bank accounts; but it explains why most working-class spending is done by cash payments, and not by cheque.

The banks of which I have been speaking are the ordinary deposit banks, sometimes called 'commercial banks', such as the Midland, Westminster, Provincial, Lloyds and Barclays—to name those which in Great Britain are called the 'Big Five'. There are also smaller commercial banks of the same kind, such as Martin's and Williams Deacon's, and certain more specialized financial houses which do some ordinary deposit banking. In addition to these there are Savings Banks, including both the Trustee Savings Banks specially recognized by law and the Post Office Savings Bank maintained by the State itself. There is also at Birmingham a Municipal Bank; but other municipalities which have tried to set up their own banks have failed to get the requisite powers from Parliament.

Savings banks differ from the commercial banks in that they deal mainly with small deposits and with money which is meant to be saved up rather than withdrawn speedily in order to meet ordinary current expenditure. Savings bank deposits are, of course, often drawn upon to meet charges for which persons with small incomes save up over a period of weeks or months; but they are not ordin-

arily used for meeting regular weekly payments. Usually, such accounts are drawn upon, not by cheque, but by the presentation of a bank-book, the payment being thereupon marked up in the book and paid out in cash. Thus, savings bank deposits do not circulate as a rule from owner to owner in the same way as commercial bank deposits, and can hardly be regarded as 'money' in the same sense. They are convertible into money on demand; but they are not themselves 'money' in the sense in which I am at present using the word.

So far, I have been speaking as if bank deposits consisted entirely of sums deposited in the banks by their owners. This is the case with deposits in savings banks, but not with deposits in the commercial banks. A considerable part of the total which figures as 'deposits' in the accounts of the commercial banks consists, not of sums deposited by the owners, but of *advances* made by the banks to their customers. These advances take two forms—*loans* and *overdrafts*. When a bank makes a loan, the sum lent is credited directly to the borrower's account and becomes a deposit in his name, with a debt to the bank standing against it. When a bank grants facilities for an overdraft, the sum allowed is not credited at once to the borrower, but is added to, and at once subtracted from, his deposit as he writes cheques against it. The bank, of course, charges interest on both loans and overdrafts, at whatever are the prevailing rates. The normal period for which industrial and commercial, or personal, advances are made is six months; but they can often be renewed for a further period.

Bank advances can be made to individuals for their private spending; but the great majority of them are made to businesses, large and small, for financing the costs of production or trade over the period between the incurring of expenditure and the receipt of payment for goods or services supplied. Some businesses can usually finance their operations out of their own capital, without calling for loans or overdrafts from the banks. But many businesses, especially trading businesses, habitually carry overdrafts, which vary in size according as trade is busy or slack. Banks also advance money on special terms to financial specialists for the discounting of bills or for stock market transactions; but I wish to leave these particular types of loan out of consideration for the present, and to come back to them later.

When a bank grants a loan or overdraft, the borrower draws upon it by writing cheques, and the sums advanced thus pass into the hands of others, who for the most part pay them in to their own bank

accounts. Thus, a loan granted by a bank reappears, in the same or in a different bank, as a sum deposited by the recipient. When a bank receives a deposit, there is no means of telling whether it arises out of money belonging to the person who drew the cheque, or out of an advance made to him by his bank.

This point is important, because it provides the answer to a question about which there has been much foolish and unprofitable disputation. Bankers sometimes indignantly deny that they 'create' money, and maintain that they do nothing more than lend out to some people money which others have left idle in their hands. This is not true. Every time a bank makes a loan or overdraft, it creates purchasing power, that is, money, which would not otherwise exist; and the banker, when he does this, has no means of telling whether what he is lending out is based on a deposit which someone has made out of his own money or on a loan or overdraft made by some other bank or even by the same bank to some other borrower.

It is, however, quite true that the power of the commercial banks to create money is by no means without limit. As we shall see later, in countries which possess a developed system of central banking, it is narrowly restricted by the policy of the Central Bank. In such countries, this limit in the main replaces the limit which is set to commercial bank lending, in the absence of an effective Central Bank, by considerations of prudence. Where there is no Central Bank, the limitations on the power of commercial banks to create deposits by making advances are twofold. First, if one bank outruns others in granting advances, it will find the other banks making claims upon it which it will have to meet in cash or bullion; for the recipients of its advances will draw cheques in favour of persons who will pay most of them into other banks, and these other banks will accordingly make claims upon it. This means that the various commercial banks are to a large extent bound to follow a common policy in making advances, so that their claims on one another tend to cancel out. Secondly, some part though not the whole of what the banks advance will be called for in the form of cash, and not of a mere transfer of bank deposits; and the banks must therefore avoid creating claims for cash against themselves beyond what they are in a position to meet. This second limitation is important in countries in which the banking system is relatively undeveloped. It does not count for much in countries with advanced banking techniques; for in such countries the amount of notes and coins available is usually regulated so as to meet all demands arising out of the amount of

'bank money' that is allowed to exist, and the factor subject to control is the amount of bank deposits rather than that of cash. The first limitation, however, applies to advanced equally with more primitive banking systems; for even where there is a strong Central Bank it is necessary for the various commercial banks to keep in step one with another in order to avoid having to meet claims for the transfer of cash, or its equivalent. In advanced countries there is almost always a Bankers' Clearing House, to which most of the important banks belong; and cheques drawn upon one bank and payable to someone's account in another are cancelled out against similar cheques drawn the other way round, so as to leave only quite small balances to be settled between banks, as long as they are following a broadly common policy.

The bank deposits which are to be regarded as money thus include the loans and overdrafts made by the banks themselves, as well as the sums actually belonging to their depositors; and the two are indistinguishable, because the sums advanced are paid over to others, who pay them into their banks as their own property.

So far, then, the 'money' we are discussing consists of coins, notes, and bank deposits. Some, however, of the coins and notes in existence are not circulating in the hands of the public, but are held by the banks as till-money, or as a reserve against claims for cash that may be made upon them by their depositors. The banks do not keep more money in this form than they think they need to meet probable claims*; for money so kept earns no interest. But the total amount of cash lying at any moment in the banks, and therefore not in active circulation, is bound to be quite considerable. It would, indeed, be much larger than it is were it not for the fact that under the banking system which has grown up in Great Britain —and has been to a great extent imitated elsewhere—the Central Bank, that is, the Bank of England, acts as a reserve repository of cash. The commercial banks can at any time draw from the Bank

* Or, rather, they do not keep more than they need in the two forms of reserves of till-money and deposits in the Central Bank, taken together. In fact, commercial banks did tend, at any rate up to the early 'thirties, to keep an unnecessarily large reserve in notes, when they could just as well have kept fewer notes and a larger balance on the books of the Bank of England. The Macmillan Committee drew attention to this tendency, and pointed out that, as neither kind of holding earns interest, it must be indifferent to the commercial banks which they hold, provided their holdings of cash are sufficient to meet real needs. It therefore advocated a reduction in commercial bank holdings of notes, as a means of narrowing the gap between the real and the apparent note circulation.

of England such supplies of till-money as they require; they can do this, because they keep at the Bank of England accounts which are always in credit, and can be drawn upon at will. This involves that the Bank of England itself must keep in its banking department a reserve of coin and notes which is available for meeting these demands; but the total supply of cash thus held in reserve, and not in circulation, is very much smaller than it would need to be if each bank had to keep a reserve of its own adequate to deal with any contingency. That this was necessary was an outstanding weakness of the American banking system before the reforms of 1913, which set up the Federal Reserve Banking system; and a similar diffusion of reserves among a large number of separate banks existed in Great Britain in the early days of commercial banking. There must always be, under any banking arrangements, some reserve of notes and coin kept out of active circulation in order that it may be available in case of need. But the size of the reserve required can be greatly reduced by linking the banks together in a co-ordinated system and using the Central Bank as a bank of reserve.

If cash consists of token money, of little or no intrinsic value, the real cost of holding a reserve supply of it is negligible. It costs the Bank of England nearly nothing to print the paper notes which form the main part of its reserve. Cost considerations arise only if a reserve of something more valuable has to be kept against the notes themselves. Before 1914, when the reserve consisted partly of gold sovereigns, it cost an appreciable sum to maintain it, for the Bank of England had to pay the Mint for the gold of which these sovereigns were made and no interest could be earned on them as long as they remained locked up in the vaults. To the extent to which the notes held in reserve are backed by gold bullion lying in the Bank's vaults, a similar cost is incurred. Under the arrangements made for governing the issue of bank-notes at the time when the Treasury Notes were transferred to the Bank of England, there was to be a fixed 'fiduciary' issue—that is to say, an issue of notes not backed by gold—and all notes issued in excess of this fixed issue were to be covered up to their full face value by gold held by the Bank. The fiduciary issue was not, however, fixed absolutely. Normally, it was to amount to £260 millions—a sum settled on because it seemed to approximate to what would be needed to replace the Treasury Notes that were to be withdrawn; but power was given to the Bank of England to apply to Parliament to vary the amount of the permitted fiduciary issue, and it was from time

to time both raised and lowered after the Act of 1928. It remained, however, fairly near the original figure right up to 1939. In the second quarter of that year the average note issue was £526 millions, against which the Bank of England's Issue Department held about £260 millions in gold coin and bullion (valued at 158/6d. per oz. fine). Of these notes £32 millions were in the Banking Department —that is, were not in actual circulation. In September 1939 the Bank of England's gold reserve was transferred to the Treasury, and the entire issue of Bank notes became fiduciary. Its amount increased rapidly as incomes and prices rose during the war. By 1945 it had reached an average level of £1,311 millions, of which only about £27 millions were in the Banking Department. The highest level up to 1951 was reached in 1947—£1,450 millions, of which the Banking Department held £66·5 millions. The total fell in 1948, and has since fluctuated as follows:—

TABLE II

BANK-NOTE CIRCULATION, 1948-1953

	Weekly Averages £m.					
	1948	1949	1950	1951	1952	1953
In circulation . . .	1,254	1,269	1,287	1,342	1,435	1,532
In Banking Dept. . .	59	46	41	41	41	39
	1,313	1,315	1,328	1,383	1,476	1,571

Under the conditions which existed up to 1939, the holding of a reserve in notes by the Central Bank did involve cost; for the need to hold a reserve in notes meant that the total supply of notes had to be higher than it would have been if only enough to meet the demand for actual cash circulation had been issued, and, as the total note issue exceeded the fiduciary limit, it followed that the additional notes needed to constitute the reserve had to be backed by gold, and therefore cost whatever it cost to hold so much gold idle. The position was somewhat different in most other countries; for most Central Banks were not tied down to a fixed fiduciary issue, but only to the keeping of a supply of gold representing a certain *proportion* of the notes issued. This meant that the cost of maintaining

a reserve of notes was lower—only half as great if the proportion required was 50 per cent., and so on. The cost, however, must exist, wherever there is any requirement that an increase in the manufacture of paper money shall be accompanied by an increased holding of gold.

In war, of course, such requirements go by the board and notes are issued in the quantities needed to finance cash expenditure irrespective of gold holdings. Under such conditions, the very notion of a reserve loses its significance; for the printing press can always be resorted to, and the quantity of notes kept as till-money by the Central Bank becomes a mere matter of convenience.*

The supply of cash consists, then, of the notes and coins in the hands of the public—which, less any hoarding, constitute the active cash circulation—*plus* the till-money held in notes and coin by the commercial banks, *plus* the reserve of secondary till-money held in notes and coin by the Central Bank. Only the first of these makes up the *active* circulation. Of course, cash is continually flowing into and out of the commercial banks; but we must understand their 'till-money' as meaning the amount held by them in excess of their normal outgoings. This is not, in practice, a fixed amount; for the active circulation varies at different times in the week, as wages are paid and thereafter returned *via* tradesmen and others to the banks, and also at different times of the year, especially round about Christmas and at times of holiday, when the public spends more in cash and therefore makes larger demands for it upon the banks. At the rush seasons, the commercial banks will make calls for additional cash on the Central Bank, which will have to keep a reserve adequate to supply them, or to be empowered to issue additional paper money to meet the emergency need.

Under the present system the amount of the fiduciary issue is flexible: it is regulated from time to time by the Treasury at the request of the Bank.† This enables the Bank to issue additional notes

* It is not, under such conditions, usually the printing of additional notes that causes the inflationary increase in the supply of money. The additional notes are needed because there has been an increase in bank credit. See next page.

† Between 1939 and 1953 the amount of the fiduciary issue was governed by the Treasury under an emergency Defence Regulation. Before 1939 the statutory limit was £300 millions; but by the time the Currency and Bank Notes Bill was introduced in November 1953 the fiduciary issue had been raised under this wartime power to £1,625 millions. The new Act fixed the normal limit at £1,575 millions, but gave the Treasury power to increase it for periods of six months or less, subject to the condition that no increase thus authorized should

to meet the additional Christmas demand, or to deal with a rise in the need for cash consequential on an increase in prices or in the volume of transactions without any relation to the gold reserve—which, indeed, is now the property, not of the Bank, but of the Exchange Equalization Fund. The supply of notes is thus now entirely divorced from the size of the gold reserve.

It used at one time to be supposed that the key to a right monetary and banking policy lay in taking the right measures to regulate the supply of *cash*. This view lay behind the Bank Charter Act of 1844, which furnished the foundations for the modern system of central banking. That Act laid down careful regulations under which a limit was set to the fiduciary issue of paper money, and the permitted issue was gradually concentrated in the hands of the Bank of England under the provision which caused the note-issuing rights of other banks to be progressively withdrawn. The draftsmen of that Act, very mindful of the unregulated issues of paper money which had occurred during and after the Napoleonic Wars and of the instability of the banking system which had been manifested in numerous bank failures, believed that if they could but put the issue of notes on a sound and conservative foundation the rest of the financial system could safely be left to look after itself without interference from the State. In this belief, they set up a régime under which increased supplies of cash could be made available only as a result of increased supplies of the precious metals being acquired by the Central Bank; and they did this at a time when the world supply of gold was increasing but slowly. If their legitimate expectations had been fulfilled, it would have been impossible for the supply of cash to be increased at all rapidly, and any large increase in the quantity of goods and services needing to be exchanged would have had to be dealt with without a parallel increase in the cash available for effecting the exchanges. If this had happened, prices would have been forced down.

In fact, all the expectations of 1844 speedily proved to be wrong. Within a few years the great gold discoveries in California and Australia brought with them a vast increase in the annual addition to the supply of monetary gold; and this enabled the Bank of

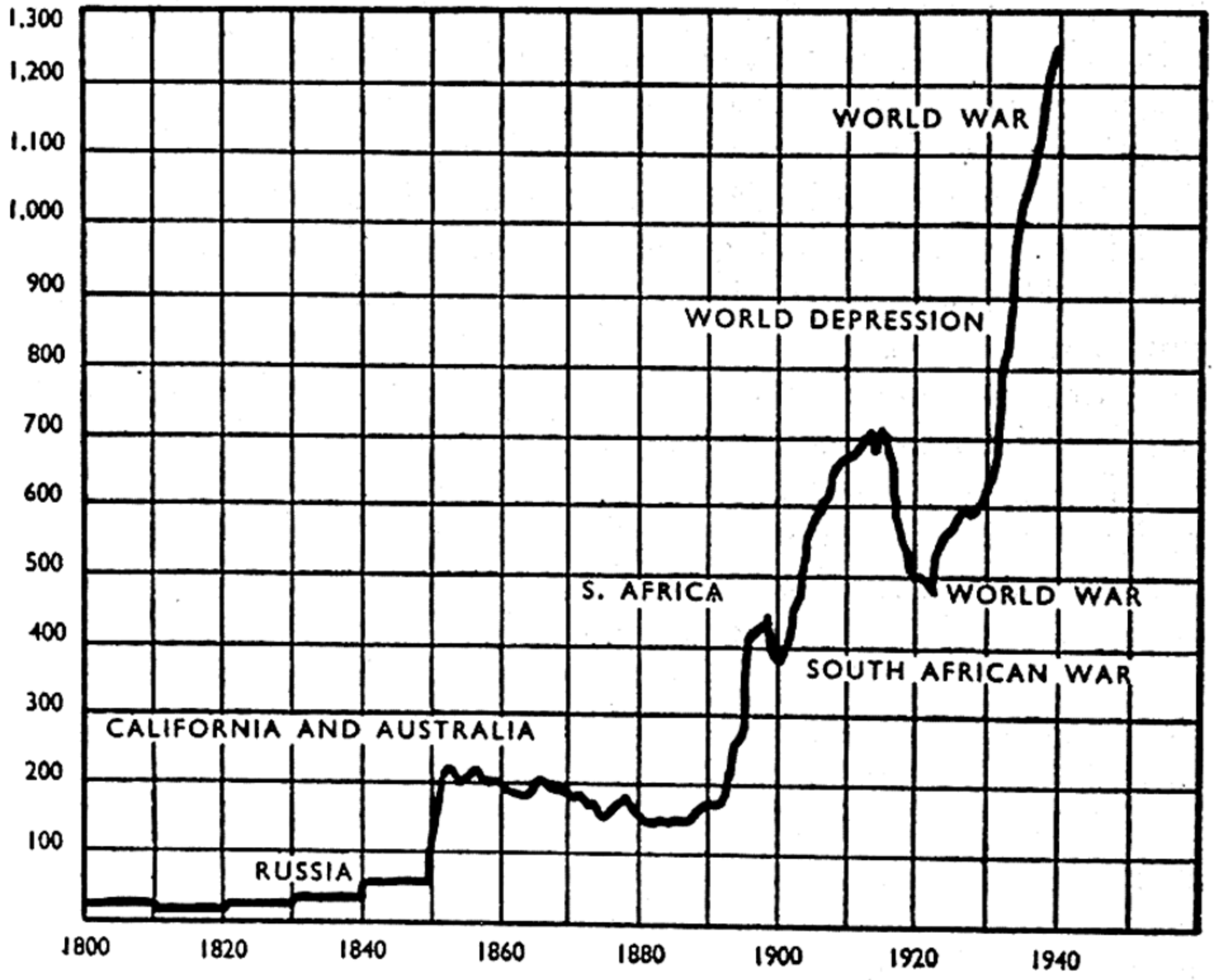
continue for more than two years without the sanction of a statutory order laid before the House of Commons. The Act of 1953 further gave the Bank of England power to issue notes of any denomination: it had previously had no authority to issue notes of a denomination of less than £5, except the £1 and 10/- notes taken over from the Treasury in 1928.

England to issue an increasing supply of paper money, and the Mint of sovereigns, far beyond what had seemed possible in 1844. But this was not all. During the years which followed the Bank Charter Act banking methods were revolutionized by the rapid spread of the cheque system, with the result that many transactions which would previously have been settled in cash were dealt with by cheque so as to make no call on the supply of cash. There was more gold to serve as a basis for the issue of cash; and each unit issued went

CHART I

World Gold Production, 1800-1940

Thousands of Kilograms



further, because it became possible, through the extended use of cheques, to raise upon it a larger superstructure of credit. Consequently, in the 1850s, prices, instead of being driven downwards by shortage of gold-based money, rose in consequence of its plenty and of the economies made by the cheque system in the use of cash.

Under the new conditions, men continued to think of *cash*, and accordingly of the gold on which the amount of cash depended, as the ultimate regulator of the supply of means of payment, and to regard the *credit* supplied by the commercial banks as a superstructure

raised upon the foundation of the available gold. So, in a sense, it was; for the supply of cash, which, with the fiduciary issue fixed by law, depended mainly on the Bank of England's holding of gold *plus* the number of gold sovereigns in circulation or in the possession of the commercial banks, set limits to the amount of purchasing power which could be created. There had to be enough cash to meet the demands made for it by the banks' customers; and the demands so made would be affected by the amounts of loaned purchasing power which the banks advanced in credits. The banks therefore could not create credits on such a scale as to lead to demands for cash which they would be unable to satisfy; but the more their customers, instead of paying one another in cash, took to doing so by transferring their bank deposits by cheque without demanding cash, the larger became the credit superstructure which the banks could afford to raise upon any given cash basis. The credit structure became more and more elastic, and would probably have become even more elastic than it did had not the increase in the supply of gold been enlarging the cash basis at the same time.

This is not the place to pursue the history of the later developments either of gold supply or of the elasticity of the credit structure. I am not writing a history of monetary development, but only a commentary illustrated from history as need arises. Gold supplies languished again in the 'eighties and 'nineties until the further gold discoveries in South Africa brought a vast accession to ease the strain. Meanwhile, the extension to further countries of advanced banking methods based on the gold standard increased the demand for gold; and as against this the continued spread of the cheque system added to the elasticity of the credit structure. Gradually, bankers settled down to a series of conventions about the volume of credit which they could venture to base on any given amount of cash; and gold seemed still to be the master, because the amount of cash appeared to be regulated by the available amount of gold.

There grew up, however, in Great Britain, one convention which was in time to undermine the supremacy of gold as the regulator of credit. The commercial banks, as we have seen, keep deposit accounts at the Central Bank, and can always draw on the Central Bank for cash by cheques on these accounts. Consequently, the commercial banker comes to regard any amount standing to his credit in his account at the Central Bank as being as good as cash, because he can always get cash for it. Accordingly, the commercial banks count *as cash* the whole of the sums standing to their credit at

the Bank of England, even if the Bank has not in fact nearly enough cash in hand to pay out in cash if all these sums were asked for at once. The effects of this are, first, to enlarge the nominal 'cash' basis on which the superstructure of credit is raised, and, secondly, to transfer to the Bank of England the obligation of deciding how much credit there shall be—or, at all events, a maximum beyond which the creation of credit shall not go. For the Bank of England, if it is to be in a position to honour all demands for cash that are actually made upon it, must take steps to ensure that these demands do not go beyond what it can meet. It must therefore prevent the commercial banks from granting credits on such a scale as would lead to an excessive demand for cash.

But how is the Bank of England to do this? It has no control by law over the amounts which the commercial banks lend to their customers. It has, however, the power to affect the amount of the balances standing to the credit of the commercial banks in its own books, and thus of reducing or increasing the 'cash basis' on which these banks regard themselves as entitled to erect a superstructure of credit. The method by which the Bank of England can affect these balances is known as engaging in 'open market operations', by which is meant the purchase or sale of securities in the stock market. Whenever the Bank of England sells a security, the purchaser has to make payment to it, and will do this in most cases by means of a cheque drawn on his account in one of the commercial banks. The balance of the bank concerned will thereupon be diminished by the amount of the cheque, and this will involve a corresponding reduction in the 'cash basis' on which that bank rests its creation of credit. Any considerable sale of securities by the Central Bank will result in a reduction of the balances of all the leading commercial banks, and will be effective in reducing the credit superstructure, provided that these banks adhere to the conventional ratio between their holdings of 'cash', including their balances at the Central Bank, and the amount of credit they supply.

Purchases of securities by the Central Bank naturally have opposite effects. The Central Bank pays by cheque the sellers of the securities; and the sellers pay the cheques into their accounts in the commercial banks. The commercial banks then present the cheques to the Bank of England, which credits their accounts with the sums involved, and thus increases the 'cash basis' on which they feel entitled to erect credits. There is only this difference in the working of the two processes: the commercial banks, unless they are prepared

to alter their conventional ratios, *must* restrict credit when the Central Bank deprives them of 'cash'; but they *need not* expand their advances when their 'cash basis' is enlarged. They have, doubtless, a strong inducement to do so; for they earn interest on their advances, and have therefore good reason for advancing as much as they dare. They will not, however, make advances except to borrowers whom they deem credit-worthy—that is, likely to be able to meet the interest charges and to repay the principal at the due time—nor can they make advances unless they can find persons who are ready to borrow. It may be the case that an enlargement of the 'cash basis' by the Central Bank will fail to bring about an enlargement of the credit superstructure, either because there is a dearth of borrowers or because the borrowers who do present themselves are not deemed to be credit-worthy by the commercial banks. In other words, 'open market operations' on the part of the Central Bank are much more assured of success when their object is to contract credit than when their object is to expand it.

Even within these limits, the success of the Central Bank's policy depends, not on any power placed in its hands by law, but on a pure convention. If the commercial banks choose to disregard the cash-credit ratio which is traditionally observed, there is no *legal* obstacle in their way. They do in fact to some extent disregard it, by allowing themselves a little elasticity when they feel so disposed. But, in the main, they observe the conventional limit; and no one bank can break away far from it unless the other banks are prepared to behave in the same way. This is because any bank which outran its fellows in expanding credit would at once find itself paying over to the other banks more than it was receiving from them; and, as the commercial banks settle their mutual indebtedness by transferring sums to one another's accounts out of their balances at the Bank of England, the bank which granted credit more freely than the rest would find its 'cash basis' reduced by these transfers, and would thus have to face a still wider gap between its available 'cash' and the credit raised upon it, with the prospect of finding its balance at the Central Bank exhausted if it persisted in its course.

No such condition would apply if all the commercial banks were to act together. They could, by doing so, expand their credits to any extent, by altering their notion of the appropriate ratio between 'cash' and credit. But, if this happened, the Bank of England could, by continued open market operations, go on depleting their 'cash' until their balances were exhausted, so that they would no longer be

able to call on it for further supplies to replenish their 'till-money'. In practice, such a situation would never arise. The Bank of England and the commercial banks work in together as parts of a single system. They may bicker, and have their differences, from time to time; but the commercial banks are much too well aware of the importance of keeping in with the Bank of England ever to engage with it in a trial of strength that might bring the entire system crashing down.

The general conclusion is that, under the prevailing conditions, the available supply of credit, though it is actually issued for the most part by the commercial banks, depends on the Bank of England, which can make credit scarce or plentiful practically at pleasure by means of open market operations. The commercial banks create credit, by making advances to their customers; but how much credit they can create depends on the policy followed by the Central Bank.

Thus the Central Bank, though legally it is the guardian only of the currency—that is, of the supply of bank-notes—is in practice no less the guardian of the supply of credit available to the business world. Moreover, whereas in earlier days the Central Bank did in fact regulate the supply of currency and leave the other banks to follow their own devices in the matter of credit, nowadays it tends more and more to think first of regulating the supply of credit, and to regard the supply of cash in the form of notes as quite a secondary matter. The amount of notes required is derived from the amount of credit created. If so much purchasing power is made available to borrowers in the form of bank advances, they will tend to draw out so much in the form of notes and coin in order to pay wages and meet such other expenses as require cash money. The Central Bank must therefore make available whatever amount of cash is called for as a result of the amount of credit which it allows to be created. Instead of the supply of cash in the form of notes and coin governing the supply of credit, the amount of credit that is made available comes to determine the call for cash.

This truth is concealed because of the double sense in which the term 'cash' is currently employed. In the narrower sense, cash consists of coins and notes: in the wider, it includes besides these the balances standing in the Central Bank to the credit of the commercial banks, because these are treated as equivalent to cash in the narrower sense. These so-called 'cash balances' have, however, in truth a key function of their own. They are not cash in

the ordinary sense, but the instrument whereby the Central Bank regulates the supply of credit.

This distinction was very clearly illustrated when, in the inter-war period, a difference of view arose between the Central Bank and one of the 'Big Five' about the amount of credit that ought to be created. The recalcitrant bank, the Midland, held that the Bank of England was pursuing an unduly restrictive policy. It therefore proceeded to build up, by buying gold, a special cash reserve of its own, on which it proposed to erect a superstructure of credit, thus enlarging the total credit supply beyond what the Bank of England regarded as appropriate. The Bank of England promptly met this move by open market operations which reduced the balances of all the commercial banks in its books to such an extent as to offset the Midland Bank's gold. The other banks, finding their 'cash basis' narrowed, thereupon turned on the Midland, which was forced to abandon its expansive policy. This incident clearly illuminated the truth that the volume of credit no longer depends on the amount of gold available as a foundation for currency, but on the view of the Bank of England as to the appropriate level of total purchasing power.

This control by the Central Bank over the supply of credit, in the form which it assumed between the wars, amounted to a repudiation of the gold standard in its traditional form, even before Great Britain had formally 'gone off gold' in the crisis of 1931. Under the old gold standard, the theory was that, in general, the Central Bank should remain passive as a recipient of such gold as was offered to it at the standard price, and should proceed to create whatever amount of notes it was entitled to create on the basis of its gold stock. Even before 1914, the Bank of England did not behave quite so passively as this theory implies; but broadly it did act on the principle of using such gold as came its way as a basis for the issue of currency (which in those days included gold coins obtained from the Mint) and leaving the other banks to erect the appropriate amount of credit on this substructure of cash. But after 1918 the Bank of England was never merely passive; and even when the gold standard was normally restored in 1925, it did not come back in its traditional form. During the war, the supply of currency, including Treasury Notes, had come to be merely derivative from the supply of purchasing power issued in other ways; and in effect this situation continued after the war, with the difference that the Bank of England was continually operating on the supply of credit with the object of confining it within limits compatible with the

available stock of gold. Or rather, up to 1925, the Bank of England was trying to compress the credit supply in order to be able to restore the gold standard at the pre-1914 parity; and after 1925 it was continuing to compress the credit supply in order to be able to remain on the restored standard. This lasted up to 1931, when Great Britain was driven off gold in the course of the world crisis; but even thereafter the Bank of England was continuing to manipulate the supply of credit so as to limit the amount of depreciation of the gold value of sterling. The Bank was behaving nearly as if Great Britain were still on the gold standard, at a changed parity; and it continued so to behave until the crisis had passed its worst.

In effect, instead of regulating the currency and leaving credit to look after itself, the Central Bank took to regulating credit directly, in the light of its knowledge of the conditions affecting the currency. From 1933 onwards, the ways in which it did this were greatly affected by the existence of the Exchange Equalization Fund, to which I shall come later; and one result of the Fund was that the Central Bank was enabled to apply a policy which cut the regulation of the supply of currency largely away from fluctuations in the national stock of monetary gold. These, however, are points too complicated to be followed up at this stage. What is pertinent here is that credit supply, which in the nineteenth century was in the main regarded as something that would look after itself as long as the currency was managed on sound lines, came to be a matter for direct and constant regulation by the Central Bank, which thus made itself responsible for controlling the total amount of purchasing power available for financing money transactions of every kind.

We can now come back to our original point of departure. We have seen that, in the world of to-day, not only coins and notes, but also bank deposits, have all the essential qualities of 'money', in the sense of generalized purchasing power transferable from person to person. We have seen further that bank deposits constitute by far the largest element in the total supply of 'money' in this sense, and that the volume of bank deposits is under effective regulation by the Central Bank. Now that gold sovereigns no longer circulate in the hands of the public, coined money has lost all independent significance: it is merely the small change that is used in retail transactions and is made available in such quantities as are needed as a consequence of the major decisions which regulate the supply of money in a wider sense. Bank-notes are vastly more important than coins; but they too fulfil a subordinate function and are supplied in such

quantities as are needed in consequence of the policy followed in regulating the volume of bank deposits. Bank deposits are, in effect, the predominant element in the supply of money; and the determination of their volume by the Central Bank is the essential factor in settling the plenty or scarcity of the means of payment.

When a country is working under the gold standard and is allowing its internal monetary policy to be settled for it by the condition of the gold supply in the hands of its Central Bank, its power to increase the volume of bank deposits is limited finally by the demand for cash to which the regulations affecting the issue of currency allow it to respond. Loss of gold through the foreign exchanges involves a contraction of the supply of currency, and this in turn necessitates restriction in the supply of credit. In practice, under these conditions, Central Banks take action to restrict credit before the point is reached at which there is any felt shortage of currency; for they take steps to check the depletion of their currency reserves before these have reached the point of exhaustion: so that the element which is in fact made subject to regulation is credit—that is, the volume of bank deposits—and not the amount of issued currency. Even under the gold standard, under modern conditions, credit rather than currency is the factor on which the monetary authorities operate, although their operations are influenced by the legal requirements affecting currency.

When a country is not on the gold standard,* and the rates of exchange between its money and the monies of other countries are therefore not fixed automatically within narrow limits, credit is even more evidently the key factor. The object, generally speaking, of severing the automatic link between the national currency and gold is to obtain freedom to pursue a credit policy corresponding to national needs, instead of being compelled to follow an internal policy designed to preserve the external value of the currency intact. Accordingly, it is to be presumed that a country not on an international monetary standard will hold itself free, within limits, to pursue a credit policy appropriate to its internal needs—the limits being that it will not wholly disregard the effect of its internal policy on its balance of trade or on the value of its currency in relation to foreign monies. Its monetary authorities can behave more as if they were still on the gold standard, or less. They can either allow the external value of the currency to fluctuate freely, without attempting to influence it, or they can set themselves any level they please as

* Or on any international standard having similar effects.

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appropriate for the value of their money in terms of others, and thereafter adapt their internal credit policy to holding their money at the chosen external value, while retaining their freedom to alter at any time the external value to which they attempt to make it conform. They can, in other words, put such relative weights as they please on the two objects of adjusting the internal credit supply to domestic needs and of holding the external value of the currency stable at any chosen level. Whatever they do, the factor which they will set out to regulate will be primarily the supply of credit, rather than the amount of currency in circulation.

We can, then, safely conclude that credit policy is the key factor in modern monetary management, and that bank deposits are the predominant form of money. Coins and notes alike have become subordinate elements in the total monetary circulation: the main kind of money now in use takes the shape, not of token currency, but of book entries in bank ledgers, transferable from owner to owner by means of cheques, without any notes or coin necessarily changing hands.

There are, however, other claimants besides coin, notes, and bank deposits to the name of money. The 'bill of exchange' is a much older credit instrument than the bank deposit transferable by cheque; and it retains a high importance. In this country, trade bills are used chiefly in foreign trade transactions, and comparatively little use is made of them in commercial transactions of a domestic character. This was not always the case. Before the development of the cheque system bills were extensively used in settling debts between manufacturers or traders and their suppliers within a single country; and they are still so used on occasion. But for the most part the bank overdraft and the cheque, along with an elaborate system of trade credit, have supplanted the bill in the financing of internal exchanges of goods.

A 'trade bill' is a promise to pay at a fixed future date. It is drawn by the creditor—e.g. the supplier of goods to a trader—upon the recipient of the goods, and is payable by the debtor after so many months—often three—by which time he is expected to have put himself in funds by selling and getting paid for the goods supplied. The creditor 'draws', i.e. makes out, the bill upon the debtor: the debtor accepts it by endorsing it, and thus promises payment at the due date. This is the simplest form of bill. It is usually drawn because the creditor does not want to stand out of his money until the debtor is ready to pay. He wants to borrow from someone else

the trade credit he has granted to the debtor. Accordingly, he gets the debtor's written promise to pay at a certain date, and also makes himself responsible for 'taking up', i.e. paying off, the bill in the event of the debtor's default. The bill thus bears two names—the creditor's and the debtor's; and it is therefore saleable for immediate cash on the combined guarantee of the two. This makes it more saleable than it would be if it bore only a single name; and there are persons with available money who are prepared to buy the bill at once if the names are good. Naturally, no one will pay for it the full value for which it is cashable at the due date; for interest will be demanded on the sum locked up in the bill until it falls due. This interest will take the inverted form of a 'discount'—that is, of a deduction from the face value of the bill corresponding to the period for which it has to run and to the prevailing rate of interest in the money market. 'Discount' is simply interest upside down.

Clearly, a bill which bears two unknown or little-known names will be less readily discounted, i.e. bought for cash down, than a bill with well-known names upon it. Accordingly, the traders who draw and endorse bills can add to their acceptability if, instead of using their own names, they can use those of banks or other well-known financial institutions whose solvency is unlikely to be questioned. The practice has therefore grown up of traders arranging with their bankers to *accept* their bills on their behalf, thus substituting their names for the names of the parties to the transaction. The bank, or other financial institution, makes a small charge for this service; and the bill is converted from a 'trade bill' into a 'bank bill', which commands a wider market. It can then be readily discounted; and the trader who has granted credit to his customer can thus get his money at once, subject to the discount, instead of waiting for it until the bill matures. The credit, of course, is not annihilated, but only transferred: whoever discounts, i.e. buys, the bill becomes the supplier of the credit.

Now, bills of this sort can be discounted, not once but, if their holders think fit, over and over again, before payment falls due. If the purchaser of the bill wants ready money, he can sell it, adding if need be his own name, so as to make himself responsible for payment if the original signatories default. Bills of exchange, therefore, though they are in form not essentially different from post-dated cheques, being simply promises to pay in the future, do not, like cheques, simply operate in a single act of transferring purchasing power. They resemble bank-notes, in that they often carry a bank's

guarantee; and they are also, like bank-notes, capable of being passed on from hand to hand in settlement of debts.

Bills, however, are not 'money' in anything like the same sense as bank-notes. Their range of circulation is ordinarily very limited, and has become much more limited since the general development of the cheque system. In the eighteenth century, as readers of old novels, such as Daniel Defoe's, will be aware, it was common for merchants to carry about bills and use them for settling day-to-day transactions which would nowadays be settled by cheque; and loss or theft of such bills was a common occurrence. In these days, bills usually circulate only within a much narrower field. The original discounter may sell them; but he will usually do so either to a bank or to a regular dealer in bills. He will not use them for making ordinary commercial payments. There was a good case, in eighteenth century England, for regarding bills, equally with bank-notes, as a form of money; and there still is, in parts of the world where they are still used as a substitute for notes or cheques. But in Great Britain to-day it is no longer appropriate to regard bills as 'money'. They are negotiable credit instruments which circulate in a specialized financial market. They are not, as 'money' is, widely acceptable means of payment for ordinary goods and services. The cheque, by its superior convenience, has driven them out of this particular field.

Later on in this book we shall have to consider some of the implications of this change of practice. For the present, we are concerned with it only as it affects our attempt to arrive at a working definition of 'money'. We can now at last attempt such a definition. 'Money', in the sense in which the term is used in this book, is anything that is habitually and widely used as a means of payment, and is *generally* acceptable in the settlement of debts. It may be coined money, used nowadays mainly in retail transactions and in payment of wages; bank-notes, used chiefly for the same purposes, but also to a limited extent in settling larger debts; or bank deposits, transferred by cheque. Most large transactions, and many quite small ones, are done nowadays by this last means. Cheques are not money, because they do not circulate freely from hand to hand, being merely promises to pay signed by a single person and usually completing their circulation in a single exchange. The bank deposits against which cheques are written *are* 'money', and the most important kind of money. The volume of bank deposits is the key factor in determining the supply of 'money'; and the regulation of this supply is accordingly the crucial problem in general monetary policy.

II

HOW MUCH MONEY DO WE NEED?

How much money do we need? Clearly, enough to cover the purchase of everything that we need to buy and sell. Yes, but how much does that mean: will not any amount of money suffice to cover any volume of buying and selling, if only the prices are adjusted to it? No doubt, theoretically, it will; but hardly in practice, when one is starting out, not from the beginning, but with an existing arrangement of costs and prices; for though some of these costs and prices may be fairly easy to alter, others are fixed by contract over long periods, and besides these, many are in practice very difficult to adjust. If costs and prices were perfectly adaptable, and could all be quickly adjusted in equal measure, it would not matter whether we had much money or little, provided that we could divide what we had into any units we pleased.

The amount of money matters, then, because prices are 'sticky', and above all because they are 'sticky' in widely varying degrees. A reduction in the supply of money involves either that fewer things must be bought and sold, or that some or all of the things that are bought and sold must change hands at lower prices. If some prices are fixed, at any rate for a considerable time, it will be necessary for other prices to fall all the more, in order to enable the same amount of buying and selling to be done. Alternatively, the amount of buying and selling must be reduced. An increase in the supply of money will, of course, have opposite effects.

In fact, a reduction in the supply of money is usually accompanied by both a fall in prices—in some prices, but not in all or to an equal extent—and a reduction in the amount of buying and selling. When business men find that they cannot sell as much as before at the old prices, they can either lower their prices or cut down their production, or of course they can do both. The 'stickier' their costs are, i.e. the smaller the reductions they can get in the prices they have to pay for what they use up in production, the more disposed will they be to curtail output and thus maintain the prices of what they have to sell. They may not take such decisions deliberately: they may simply find that, after they have cut their selling prices as fine as they dare, their orders fall off. Whether their curtailment of output be deliberate or not, its effect will be to throw some of their em-

ployees out of work, or to put them on short time, and thus to diminish their power to buy. This will cause other employers, from whom the dismissed or under-employed workers used to buy things, to cut output in their turn. There will be a widening circle of unemployment and of under-production as well as of price-cutting.

I have not asserted that these phenomena are *caused* by a reduction in the supply of money, but only that they *accompany* it. It is possible that the originating cause may be not in money at all, but somewhere else. If, for example, Lancashire manufacturers have been accustomed to sell a large part of their output of cotton goods in India, and India is visited by crop-failure and famine which destroy for the time the ability of the Indian people to afford Lancashire goods, some of the manufacturers will have to close their works or reduce the number of their employees or take to working short time. They will then pay out less in wages, less to the merchants who supply them with materials, less for fuel, and probably less for their personal expenses of living. Their demand for money will fall off; and if the monetary authorities merely respond to the demand the supply of money will be reduced without any deliberate decision on their part. They will find the demand lower; and they will respond by supplying less. In such a case, the fall in the supply of money is not a *cause*, but a *consequence*, of the fall in productive activity.

Some bankers like to believe that the role of money is always purely passive, as in the example that has just been given, and that they merely respond to the public's demand for money, without influencing it at all. But this is nonsense. For one thing, banks do not lend money free, gratis and for nothing: they charge interest on their advances. To some extent, the readiness of business men to go on producing will depend on the price charged for borrowed money, that is, on the rate of interest, which is one of their costs. If, when depression threatens, the banks promptly reduce interest rates, it is reasonable to suppose that business men will be readier to go on borrowing, and will accordingly curtail production somewhat less than they otherwise would.

It must be agreed, however, that the importance of this factor can easily be exaggerated. Bank interest is not, in most industries, so large a fraction of the cost of production that any probable change in the rate will have a great deal of effect on decisions about the volume of output. It will have some, and much more in some types

of enterprise than in others; but in most branches of manufacture the effect will not usually amount to a great deal.

But, secondly, bankers do not lend to all comers, but only to those they deem 'credit-worthy', that is, likely to meet interest charges and to repay the sums advanced. If, on the development of unfavourable market conditions in India, or elsewhere, the bankers take fright, and become fearful about the solvency of a number of their customers, they will be less willing to lend, and will refuse advances which they would readily have granted when conditions seemed to them more hopeful. No doubt, bankers are quite within their rights in being as pessimistic as the situation warrants, and would be acting unfairly to those who have money deposited with them if they were to lend without due caution. But how if they become unduly pessimistic, and refuse loans to borrowers who have really every prospect of solvency? They will then be causing unnecessary unemployment and under-production and will be creating the very conditions of which they are afraid: they will not be responding passively to the demand for money, but artificially reducing the supply. And bankers, in times of depression, have been apt, out of over-caution, to behave in this way.

Thirdly, there is the question of the attitude of the Central Bank. The commercial banks, as we have seen, can lend only up to maximum limits which the Central Bank is in a position to prescribe. They need not lend up to these limits; but they cannot exceed them. They have a financial inducement to lend up to the prescribed limits, in order to put the power of creating money which is at their disposal to profitable use; but this inducement no longer applies when they are afraid of making a loss instead of a gain. They may accordingly fail to lend as much as the Central Bank has made available to them; and if they are in this mood, it is not easy for the Central Bank to do anything to shake them out of it. If it further increases the supply of money, the bankers will not necessarily increase the amount of their loans. The additional money that is made available may not be used, or at all events may not be used in ways in which it will stimulate production and employment.

Most likely, what will happen is that the commercial banks, finding themselves with idle money on their hands, and fearful of embarking it in loans to productive industry, will start buying gilt-edged securities in order to earn some interest on it rather than nothing at all. The effect of such buying, reinforced by the fact that the Central Bank, if it is trying to enlarge the supply of money, will

be buying gilt-edged securities too, will be to force up the prices of such securities. But a rise in the price of fixed-interest-bearing gilt-edged securities is equivalent to a fall in the current rate of long-term interest. It means, since the prices of existing securities necessarily react on the prices of new ones, that clearly solvent business men will be able to borrow long-term capital more cheaply than before. This may induce them to borrow more, despite the unfavourable business conditions; but again we must observe that, except in a few industries, the effect will probably not be large, because business men will not be induced to borrow by a fall in the rate of interest they have to pay, if they think that the investment of the borrowed money is more likely to lead to loss than to profit. If, indeed, the business men are less pessimistic than the bankers, their response may not be negligible; but if they share the bankers' mood it is likely to be small. The power of the Central Bank to bring about an effective expansion of the money in circulation is weak at such times, unless it is prepared to act on a very large scale. If it goes on pouring money by open market operations into the commercial banks, the combined effect of falling interest rates and of its manifest determination to bring about an expansive, or 'reflationary', situation, can in the long run wear down the pessimism of the commercial bankers and of those business men who are best placed for taking advantage of the cheap supplies of money.

It may, however, need very drastic action by the Central Bank to achieve this result, including an expansion of the potential supply of money much beyond what would achieve it if the facilities for creating money were fully used. Central Banks have not usually been controlled by persons likely to be willing to take action as forthright as may be needed. They have been, and still are in many countries, much more likely to make, at most, a half-hearted attempt at reflation, and to abandon their efforts when small measures achieve no apparent success.

So far, I have been assuming that the Central Bank, instead of participating in the pessimism of the rest of the business and banking world, sets out to correct it. But this may very well not happen. We have now to ask what will occur if the directors of the Central Bank are themselves infected by the prevailing fright. They will then, instead of trying to make money more plentiful, set out to reduce the supply in order to force prices down to a level at which they believe an expansion of foreign demand will occur. In our chosen example, they will seek, by making money scarce, to bring

about a fall in the prices of Lancashire goods to a level at which the impoverished Indians will again be able to buy them.

To some extent, this policy may succeed in re-expanding sales to India—unless the Indians are so poor as not to be able to buy at the lowest prices to which Lancashire's wares can be forced down. But, even if success is achieved, the offsetting disadvantages may be heavy. The costs which make up the prices of Lancashire's products will not all be equally amenable to scaling down. Some will be fixed over long periods: some suppliers of materials will be better placed than others for refusing to reduce their prices: wage-earners will resist wage-cuts when they can, and directors and managers will be reluctant to have their fees and salaries cut down. Such cuts as are effected will be reflected in a reduction in the money-incomes which constitute the means of paying for goods and services in the home market. These reductions in spending power will face business men in other trades with the alternative of cutting their prices, or their output, or both; and they will, in total, reduce both prices (unequally for different goods) and output (also unequally). The net result may be that increased sales to India will be much more than offset by reduced sales in the home market. A 'deflationary' policy of reducing the supply of money in face of an impending or actual depression, instead of making the general state of employment and production better, will normally make it a great deal worse.

Yet the Central Bank's directors, in following such a policy, may be more than half convinced that they are not initiating anything, but are merely adjusting the supply of money to the changing state of demand. The more depression spreads, the less money seems to them to be needed: each step they take to cut down the supply curtails the demand, and seems to justify a further cut. The 'passive' theory of Central Bank action results in practice in the Bank becoming the most powerful of all the forces making for depression and unemployment. It is fully possible that the *initial cause* of the decline in the market may have had nothing to do with banking, either central or commercial. But it is certain that both commercial bank pessimism and Central Bank deflationism may be, even in such a case, *secondary causes* so powerful as altogether to overshadow the initial cause in the havoc to which they give rise.

I have, however, admitted both that commercial bankers are bound to exercise due caution and that the Central Bank's power to influence the course of events is small unless it is prepared to act on a very extensive scale. I shall have to come back to this point

in a later chapter, in which I shall deal fully with the policies which Central Banks ought to pursue in combating depression and with the non-monetary measures which are needed to make their action effective. This question will come up when we get to the vital question of 'Full Employment' and the monetary measures necessary for its maintenance. In this chapter, I am dealing with a different, though closely related, issue—that of the criteria by which a community is to judge of the amount of money it needs.

It requires, we have seen, enough to cover the purchase of everything that needs buying and selling for money. What does this include? First, the entire current output of goods and services, except goods made deliberately 'for stock', and such goods as are produced and consumed without being sold at all—the eggs my own hens lay, and so on—and such services as are rendered without money payment—my wife's as housekeeper, and mine as President of the Fabian Society, for example. Many of these current products, moreover, will be bought and sold several times over. Finished goods will pass by way of wholesalers and retailers to the consumers; and in most forms of manufacture there are successive processes, which are often carried out by different firms. The turnover of money has to cover all these intermediate transactions, as well as the buying and selling of goods at the final stage. Indeed, a good deal more money changes hands between intermediaries than in the purchase of finished goods by the final buyers.

Of course, if we take any fixed accounting period, such as a year, the whole of the year's output will not be bought and sold in that year. There will be stocks of goods at various stages in existence when the year begins, and stocks to be carried over to the next year when it ends. The magnitude of these stocks changes from time to time; and accordingly in some years more will be sold than is produced, and in other years less. This piling up and depletion of stocks —they were much depleted in the course of the war—has very important economic consequences; but we must not pause to consider them at present. We shall come back to them later.

Secondly, there are always going on transactions in goods which are not newly produced. Men buy and sell land, houses and other buildings, machinery, second-hand furniture, motor-cars, pictures, jewellery, and many other things, and second-hand stocks and shares which partly represent ownership rights in various sorts of property, and partly are mere acknowledgments of debt—e.g. Consols or War Loan or any other elements in the National Debt, as well as

that part of share values which represents business 'goodwill', and not any form of physical property. All money transactions in such durable and second-hand goods, including stocks, shares and bonds of every sort, have to be provided for by the supply of the money needed for them. But whereas the great bulk of new output is made to be sold almost at once, in any accounting period only a proportion —a very varying proportion—of the total stock of durable and second-hand goods will be bought and sold.

The most variable elements in this stock, in respect of the frequency with which they are bought and sold, are stocks and shares and land—two things round which centres a very great deal of speculative activity. Stocks and shares have, indeed, a curious capacity for being speculated in without being actually bought or sold. It is common for professional operators, and even for outsiders, to contract to buy stock market securities without any intention of ever entering into possession of them, and to contract to sell securities which they neither own nor expect to own. Such dealing, upon 'margins', amounts to a sheer gamble on the expectation that the market value of a particular security will rise or fall. If it rises, the speculative 'buyer' can pocket his profit without ever buying the security; if it falls, the speculative 'seller' can similarly pocket his gain. It was one of the sources of President Roosevelt's unpopularity in American financial circles that he placed restrictions on this type of gambling, making it actually unlawful in its more extreme forms. Where it exists, the quantity of securities that can be dealt in is obviously not limited to the number in existence, much less to the number actually up for sale. But money passes, whether the sale is real or fictitious, though of course the sum passing is smaller if the deal is 'on margin', so that only the difference between the actual and the contracted price has to be paid.

Stock market transactions and land speculation call for 'money', just as any other buying and selling does. But there is a difference between the effects of an increase in activity due to speculation and one that is due to a brisker market for ordinary goods and services. Speculative transactions, except some of the shadier sort, are usually settled by cheque, without the use of coins or notes: so that a boom on the stock or produce markets, or in land transactions, does not of itself call for an increase in the supply of *cash*. It increases the volume of credit outstanding, and therefore of bank deposits; but it does not call for a parallel expansion in the supply of cash money. As against this, a boom in production means that more will be paid

out in wages, which create the principal demand for cash. It is accordingly easier for the banks to finance a speculative boom than a real increase in production and employment without experiencing a demand for cash which will deplete their balances at the Central Bank and thus narrow the basis on which the credit superstructure is raised. This factor is of much greater importance in the United States than in Great Britain, because speculative activity rises to much greater heights in America and also because the banks there are much more directly involved in loans for stock market speculation.

The available supply of money has, then, subject to the reservations already made, to provide for the sale of the current output of goods and services (*plus* or *minus* changes in stocks held in reserve, and *minus* such goods and services as are consumed without being sold). It has to provide for intermediate as well as for final transactions; and it has also to cover sales of such durable and second-hand goods already in existence as change hands for money during the accounting period. Now up to a point, the more developed the technique of production and distribution becomes, the more times on the average goods tend to change hands in exchange for money on their way from the producers of the raw materials to the final consumers. When the 'division of labour' results in the splitting up of a process of manufacture into several stages, each carried out by a separate firm, the amount of money changing hands increases, even if there is no increase—more probably there is a decrease—in the final price of the goods. As against this, when a certain stage of development has been reached, there may set in a counter-tendency towards the concentration of the successive processes in the hands of a single firm or combine, and this may lead to a reduction in the number of times the goods are exchanged for money during the processes of manufacture and distribution. It may not, however, have this effect, if the firms constituting the combine, or the factories constituting the complex firm, retain their independence to the extent of buying and selling among themselves for money, rather than by means of mere book-keeping entries in their own ledgers.

This selling of the same goods at different stages over and over again, as they move up the ladder of production and distribution, increases the demand for bank credit, but, like stock market speculation, it has no corresponding effect on the demand for cash. The workmen who work for the firms concerned at the various tasks of production and distribution will not, in general, receive either more or less in wages because they are employed by a chain of firms

rather than by a single integrated firm. Of course, where the 'division of labour', instead of yielding an economy, leads to waste—for example, by superfluous handling, as it often does in distribution—the numbers employed and the wages paid may both be affected. That, however, is a different point. In general, the demand for credit is, but the demand for cash is not, much affected by the structure of business enterprise as between serial and vertically integrated firms.

The demand for 'money', then, can be expressed as the sum of (*a*) the final selling value of the current output of goods and services which are actually sold during the period under review; (*b*) the total of the successive selling values of the ingredients of which final output is made, including selling values at intermediate stages of distribution, as far as sales of these kinds are made during the period under review; and (*c*) the selling values of such pre-existing durable or second-hand goods as are actually exchanged during the accounting period. It would be possible to refine further; but such refinement would, at present, only confuse the issue.

This constitutes the demand for 'money'; but it does not mean that the *amount* of money needs to be equal to this demand. For money, as we have seen, does not perish in a single act of exchange. It goes on circulating, or at all events some of it does, from one transaction to another. The employer pays the workman his wages; the workman pays them away to a shopkeeper, or a rent-collector, or an insurance agent. The recipient probably takes them to the bank, which re-issues the same money for the payment of wages next week or the week after—and so on, until the money is worn out, when of course it can be replaced if a fresh supply is wanted.

Let us confine ourselves for the moment to the circulation of one particular kind of money—cash. Obviously, the faster it circulates and the more speedily it returns to the bank for re-issue, the less of it will be needed to finance a given volume of payments. If all the money returns to the bank in a week, the bank will need to keep a much smaller total stock than if the process takes a fortnight or a month; and to the extent to which ordinary people finance their mutual transactions by passing money to and fro among themselves without paying it back into the banks, the cash will be doing more work than if each holder of money simply keeps it by him unused for a longer time. The rapidity with which money, on the average, changes hands is known as its 'velocity of circulation'; and it has often been said that the amount of money needed to finance a given volume of transactions over a period is the sum of the money in-

volved in the transactions, divided by the velocity of circulation—that is, by the average number of transactions each unit of money performs during the period in question.

This sounds simple enough as long as one is speaking only of cash money.* But what sense are we to attach to the notion of the velocity of circulation of bank deposits? Statisticians do, indeed, calculate such a velocity, They do it by finding out the total money value of all the cheques cleared between the principal banks, and then comparing this total with the total of bank deposits as shown in the published statements of the same banks. This, to be sure, does not measure the actual velocity of circulation, in any sense; for the only cheques of which we have any record are those which involve a debit from one bank to another. If I bank at Barclays, and write a cheque in favour of someone who also banks at Barclays, the cheque will not go to the Bankers' Clearing House through which the banks settle their mutual debts. A sum in Barclays books will be transferred from my account to someone else's; and that is all. There will be no published record of such a transaction.

What, however, the statisticians are trying to measure is not the absolute velocity of circulation of bank deposits, but changes in this velocity. If the cheques passing through the Clearing Houses represent roughly a constant *proportion* of total cheques, changes in the ratio of bank deposits to such clearances will give a reasonably good picture of changes in the pace at which the possessors of bank accounts are writing cheques against them. For most practical purposes, it is necessary to break up the totals—for example, it is of importance to do what can be done to get separate pictures of the state of transactions relating to trade and industry and of those arising out of stock market speculation. This is attempted very roughly by regarding the cheques cleared between banks in central London as belonging to the 'financial circulation', and cheques for the rest of the country, including the rest of London, as belonging to the 'industrial circulation'. It is possible from the figures to get some sort of an idea of the extent to which a rise or fall in total clearings

* It is simple; but it is not the most useful way of looking at the circulation, even of cash. It is much more illuminating, and nearer the truth, to regard the banks as needing to keep a supply of cash sufficient to carry the 'peak load'—that is, to meet the highest demand that is likely to occur at any time during, say, a week. This is not the same as a measure of velocity; for the velocity with which the cash circulates at all times outside the period of the 'peak load' is practically irrelevant to the amount which the banks need to hold in readiness.

is due to up or down movements in the 'City' or in the world of industry and trade.

Such indicators are clearly useful; but has the notion of a 'velocity of circulation' of bank deposits any fundamental validity? Cash and notes, once put into circulation, remain in existence until they are worn out or deliberately withdrawn. But bank deposits are mere entries in a book, which can be created or annihilated by the banks almost at will. If a commercial bank lends £500 to Messrs. A, and then, after Messrs. A have paid it back, lends £500 to Messrs. B, is there any real sense in which the two sums of £500 are the same money performing two successive acts of circulation? If it were true that bankers did not really create money, but only lent out to one person sums left in their hands by others, as some people used to believe they did, there would be some reason for regarding the sum-total of bank deposits as constituting a money-fund and for treating successive advances as successive circulations of the same money. But this is not what happens. If it were, the making of an advance could not, as it actually does, increase the total of bank deposits by the amount of the advance. The amount of deposits would be fixed, and it would be only a question of transferring them from one possessor to another. However, as everyone knows, the amount of bank deposits is not fixed, but fluctuating. It depends mainly on the action of the Central Bank. The commercial banker may be under the delusion that he is not a creator of money, because the amount he is able to create is settled for him by the Central Bank. But that cannot alter the fact that bank deposits are created and annihilated by someone; and it seems most natural to regard them as created by the commercial bank when it makes a loan, to be annihilated as soon as the loan is repaid. That is, in fact, what does occur.

On this view, bank deposits constitute, not a perpetually circulating stock or fund, but the result of a recurrent process of creation of new deposits and cancellation of old ones. We can legitimately talk of the rate of turnover of cheques through the Clearing Houses, and we can compare this turnover with the published totals of bank deposits. But we cannot speak of a 'velocity of circulation' of bank deposits in the same sense as we can of the 'velocity of circulation' of cash. Cash does circulate from hand to hand; bank deposits follow a different process. There is a close analogy between the cash circulation and the transfer of deposits between depositors in the absence of bankers' loans; but, as soon as the factor of loans comes in,

an essential difference appears. If banks were merely institutions through which persons could transfer balances which belonged to them from one to another, we could speak of the 'velocity of circulation' of such deposits. We cannot speak of the 'velocity of circulation' of something which is continually being created and destroyed. We have, however, no means of separating bank deposit transactions into two groups, one representing transfers of sums between their owners and the other transfers of sums created by the banking system. The two cannot be distinguished. If somebody pays me by a cheque based on an overdraft, and I pay it into my bank account, it becomes indistinguishable from money paid to me out of somebody's balance, without any advance from a bank. We have to treat bank deposits as a single category, because there is no means of breaking them up.

The purpose of the foregoing paragraphs has been to show that, under modern conditions, the amount of money and the velocity of its circulation are not really two separate things, so that we can multiply the one by the other and arrive thereby at a measure of the total efficiency of the available supply of money in effecting purchases and sales. That this could be done was the belief on which rested the traditional formulation of the theory known as 'The Quantity Theory of Money'. According to this theory, which was customarily expressed in quasi-algebraical form, the level of prices would depend on the ratio between the volume of transactions needing to be financed on the one hand and on the other the amount of money multiplied by its velocity of circulation. $MV = CP$, i.e. the amount of money (M) × the velocity of its circulation (V) = the volume of transactions (C) multiplied by the average level of prices (P). That there is a truth underlying the Quantity Theory no one, I suppose, denies; but the apparent precision of the formula conceals the fact that it is made up of a number of immeasurables. M and V are not two separate things, but a complex single entity. Moreover, what on earth is the volume of transactions apart from the prices at which they take place? There is no way of comparing or adding up the magnitudes of the sale of a ton of coal and an acre of real estate except in terms of their prices. CP, like MV, is not made up of two separable entities, but is a single complex thing.

Yet it is obviously true that the more money there is changing hands, the higher on the average prices are likely to be—as long as the supply of things to be exchanged does not increase as fast as the amount of money changing hands. Common sense and experience

alike endorse this; and no one who has been through, or studied the effects of, a period of inflation will be likely to deny it. What we cannot say is that an increase of so much per cent. in the recorded total of bank deposits will produce a corresponding increase in the level of average prices, or a decrease of so much per cent. a corresponding decrease. Even if we set aside the undoubted fact that nobody ever has measured the average level of *all* prices, and nobody ever will, there remains the further fact that an alteration in the amount of money changing hands will be accompanied by an alteration in the volume of production and also by an alteration in the quantity of durable and second-hand goods exchanged. The changed 'quantity of money', if I may be allowed the inexact phrase, will not have to finance the same 'quantity of transactions'—another inexactitude—as before.

It can, I hope, already be seen that the question 'How much money do we need?' is not easy to answer. How can we tell how much money we *need*, when we cannot even say without ambiguity how much money we have already *got*? The very notion of 'quantity of money' dissolves as soon as one starts analysing it. Does this mean that we must reach a purely negative and destructive conclusion—that nothing useful can be said on the subject? Not at all. There is plenty to be said; but it is not of a sort to be reduced to formulae that look like algebra, and *are* devices for concealing ambiguity under a false appearance of precision.

What, then, can we say? That the proof of the pudding is in the eating. In most circumstances the 'amount of money' we need, or rather let us say the amount of facilities for effecting payments, is that amount which will suffice, and only just suffice, to keep the resources of production in reasonably full employment. How are we to tell what this amount is? By careful observation of economic facts and tendencies. If, on such observation, we find that resources are being under-employed, that constitutes a good *prima facie* reason for supposing that the means of effecting payments ought to be made more plentiful. If, except in time of war, we find that there is an acute shortage of productive resources, leading to a scramble for their use, and to their overwork, that is a good *prima facie* reason for making the means of payment less plentiful. It should of course be understood that I am speaking of things as they are under the present economic system in Great Britain and in other capitalist countries, and not as they might be under a quite different system, or as they are in the Soviet Union, where money plays in some

respects an essentially different role. Under our system, as it existed up to 1939, the *prima facie* case held good. It is not, however, a conclusive case in itself. It may be that the under- or over-employment of resources is confined to a particular sector of the economy, and is traceable to some non-monetary cause—for example, to a world decline in the demand for wool, or to the obsolesence of Lancashire as a centre for supplying the world with cotton piece-goods. In such cases, the remedy is not mainly monetary, though it may turn out to have a monetary aspect. It is to be sought rather in a shift of productive resources from the declining forms of production to others which cater for more expansible demands. If, however, the under-employment or over-employment of resources is general, or at least widely diffused, it is a pretty safe bet that a change in the supply of means of payment will be one essential element in the cure.

We need just enough means of making payments to secure and maintain full employment. To say this is not to say that the provision of these means will by itself suffice to bring about and to sustain such a level of employment of productive resources. It will not. But unless the means of payment are in sufficient supply, nothing else will avail to keep employment at a satisfactory level. If the means of payment are deficient, under the capitalist system unemployment will inevitably rise.

Objection may be taken to this conclusion, on the ground that, even if unemployment does arise for a time, in the long run prices will be scaled down to the required extent, so that the supply of means of payment will no longer be deficient in relation to the reduced demand for money corresponding to full employment of the available resources at lower prices. I neither affirm nor deny this. I am not interested in it. What I do know is that, as Lord Keynes has somewhere written, 'in the long run we are all dead', and that the process of adjustment is likely to be so painful and so unjust in its incidence upon different groups, classes and individuals, that no one ought to wish to face such a catastrophe unless there is no way of avoiding it. A scaling-down of the supply of means of payment with the object of forcing down prices and incomes to levels corresponding to the reduced supply will begin by bankrupting many people who, through no fault of their own, are in an especially vulnerable position. It will increase the real incomes of those whose money-incomes are fixed, and will reduce the real incomes of those whose money-rewards are variable. It will confront wage-earners

with the painful dilemma of either standing out against wage-reductions at the cost of increasing unemployment or accepting them at a sacrifice of their standards of living when they are employed. It will confront capitalist associations with a similar dilemma of either maintaining prices and reducing output or cutting prices in the hope of attracting to their wares a larger proportion of the reduced total of money-demand. It will in both these cases help the strongly placed or organized at the expense of the weak. It will upset the relations between prices and incomes, not so as to correct injustices, but in an arbitrary and irrational way. Perhaps, in the long run, things will settle down to be no worse than they were before the process started, but I cannot for the life of me see that they are likely to settle down to be any better; and what, pray, is to compensate for the sufferings and injustices of the transition?

Of course, what I have been saying about the effects of having too little money applies also to having too much. When the supply of means of payment is expanding faster than the available supplies of goods and services, the inevitable effect is to force up prices. If the prices of some things are held down by controls, either black markets develop or prices rise more in the uncontrolled parts of the economy. The structure of real incomes is distorted: those who live on fixed incomes are penalized: excess profits appear at many points. Debtors benefit at the expense of creditors; and the balance of payments has to be protected by preventing the excess purchasing power from finding an outlet in increased purchases of imported supplies. These consequences of monetary inflation were amply illustrated by developments in Europe after the first World War, when many countries passed through the experience of galloping inflation, and in some the existing currency practically lost its value. But, short of such extremes, inflation of the means of payment beyond the available supplies of goods and services can have very unfortunate effects. Since 1945 a good many countries have been living, in varying degrees, under conditions of what may be called 'controlled inflation'. With large arrears of demand to be made up, both for capital goods and for many kinds of consumers' goods, there has been a readiness to buy more of these goods than it has been possible to supply; and this has resulted in a tendency for prices and profits to rise and, in consequence, in demands for higher wages which, when met, react again upon prices. The attempt to control these inflationary forces has taken the form of 'budgeting for a surplus'—that is, of withdrawing a part of the excess purchasing power by higher

taxation than is needed to meet the current outgoings of the Government—or at any rate by meeting out of taxation a large part of the Government's *capital* expenditure in addition to its current spending. Such budgeting for a surplus is the reverse of the policy of budgeting for a deficit during a depression in order to leave more purchasing power in the hands of private citizens and thus increase demand.

We shall have to come back later to the discussion of these budgetary techniques, which have come to play a greatly increased part in government policies for the regulation of employment conditions through monetary controls. But for the present I am concerned only with affirming the importance of price-stability, and of avoiding upsets due either to an excess or to a deficiency of purchasing power. When a particular arrangement of prices exists, it is best to adjust the supply of means of payment to that level, rather than to use an alteration in the supply of means of payment as an instrument for making it different. This must not be confused with the contention that prices ought to be artificially stabilized, either generally or in particular. That is quite another question, to which I shall come later on. Prices of particular things will naturally alter, and their relation to other prices be altered, as technical conditions of production change; and I can see no reason for supposing, in view of this, that there is any virtue in stabilizing the 'general level of prices', which is, after all, only some sort of average of these particular prices. But I wish to defer argument on that issue; and I mention it here only in order to stress the difference between allowing prices to alter as technical conditions change and trying to alter them deliberately by monetary manipulation. What I am arguing is that monetary management ought to be based, broadly speaking, on accepting an existing price-structure, and not on creating a new one. This doctrine may not hold good under all circumstances—for example, it may not be fully valid where prices have been upset by a process of runaway inflation. But where the existing price-structure has become the basis for a complicated structure of long-term contracts, incomes, and supply and demand relations of all sorts, it is in general exceedingly unwise to attempt to alter it by monetary methods, if there is any alternative to doing so. In general, the right course is to adjust the supply of means of payment to the existing price-structure and the existing productive resources, so as to achieve and maintain full employment with the minimum of disturbance. But, let me repeat, this does not mean that prices ought to be artificially stabilized: it means that they ought not to be artificially upset.

III

CREDIT CONDITIONS AND THE GOLD STANDARD

THE conclusions reached in the preceding chapter were empirical. Banking is an art and not a science; and the determination of the conditions governing the issue of means of payment is a matter in which statistics may help but cannot furnish absolute guidance. Plainly the decisions which are made will be of vital importance to every section of the community. They will affect both the volume of employment for productive resources of all kinds—capital and land, as well as labour—the distribution of incomes between groups and classes, as well as their amount, and the relative as well as the absolute prices of all sorts of goods and services. They will not, of course, be the sole determinants of any of these things; but they will be of very great influence. It is therefore evidently of the greatest importance that those who make them shall act both expertly and wisely, and in such a way as to further the social and economic policies which the community is endeavouring to pursue.

These considerations apply with special force to those who are in charge of the Central Bank; for it is on the policy of the Central Bank that the most far-reaching consequences depend. The commercial banks are in the main *distributors* of credit, or perhaps better *retail manufacturers*. They depend, for the amount of credit they are able to manufacture, on the materials for this manufacture that are placed at their disposal by the Central Bank. They may make less than the Central Bank allows them to make: they cannot in general make more. As against this, the Central Bank appears rather as an autonomous creator, following its own ideas of the amount of purchasing power that is needed.

But is the Central Bank as autonomous in its creation of the basis for credit as this description suggests? In the past, most Central Banking experts, and most economists, would have flatly denied this, and would have argued that the Central Bank itself is only a *wholesale distributor*, or at most a *wholesale manufacturer*, of means of payment, dependent for the materials of this manufacture on forces outside its control, and therefore, equally with the commercial banks, limited in the amount of purchasing power that it is in a position to create. There would perhaps have been more dispute over the question whether the Central Bank *had* to create all the purchasing

power it *could* create, or was free to create less, or at all events about the extent of its freedom to create more or less within the maximum limits open to it. Some preferred to regard the action of the Central Bank as being almost automatically determined for it by rules which it was compelled to obey; whereas others put greater stress on the powers at its command for varying within limits the supply of means of payment.

The traditional theory of Central Banking was worked out on the assumption that Central Banks would either be operating under the gold standard, or would be regarding that standard as an ideal to which it was their affair to approximate as closely as their circumstances allowed. The gold standard is, in brief, a system under which the value of a national currency is fixed in terms of gold. It is laid down by law or binding regulations, under such a system, that a unit of the national currency (e.g. the pound sterling) is worth a fixed weight in gold of a standard fineness. The Central Bank is under a permanent obligation to buy gold at this fixed rate, giving national currency in exchange—or at a little less where a charge, *seigniorage*, is made by the State for the act of coinage. The Central Bank is under a similar obligation to sell gold, that is, to give gold in exchange for national currency, at the fixed rate. The Central Bank's rates for buying and for selling gold may thus be the same, where there is no seigniorage, or slightly different; but the difference has been, hitherto, not large enough to constitute a major feature of the system. In Great Britain, under the gold standard, there was no seigniorage: subject to minor qualifications, buying and selling rates for gold at the Bank of England were the same.

It is also an essential feature of the gold standard, in its complete form, that there shall be freedom to import and to export gold. Anyone, under the gold standard proper, could bring gold into the country; and anyone could take it out. Consequently, the stock of gold fluctuated, not only because newly mined gold could always be brought in for sale—as it was continually brought from South Africa to England—but also because anyone who pleased could move gold into or out of the country, either as a means of paying debts or as a means of moving capital across national frontiers. There was no necessity for all the gold that was in the country to come to the Central Bank or to the Mint. There was also an industrial market for gold—for rings, watches, gold plate, and so on—and in addition anyone who pleased could hoard gold privately, or sell it to anyone else, either inside or outside the country. Gold had

a market price for non-monetary uses; but this market price, and consequently the amount of gold which the owners of gold-mines found it worth while to produce, was in effect settled by the monetary demand for gold from Mints and Central Banks, with the Central Banks' buying and selling prices setting a minimum level below which it could not fall.

On the 'automatic' theory of Central Banking, the Central Bank was merely a passive agency in receiving and getting rid of gold. It took what people brought to it, and paid out what people demanded from it. What remained in its vaults as a result of these operations was its fund of monetary gold, on which its action in making credit facilities had to be based. As long as sovereigns, worth their weight in gold, circulated in the hands of the public, the gold reserve in the hands of the Bank was relatively small. In England, before 1914, there were, and had been since the first quarter of the nineteenth century, no paper notes of a value smaller than £5; and the gold reserve was 'cover' only for these larger notes, to the extent to which their total value exceeded the then permitted fiduciary issue, which was just under £20 millions. The Bank, at any rate in theory, issued notes covering its entire holding of gold bullion as well as the fiduciary issue; but it did not put into circulation all the notes it issued. The Bank was nominally divided into two departments (by the Bank Charter Act of 1844)—an Issue Department, solely responsible for the manufacture of notes against gold holdings and the securities covering the fiduciary issue; and a Banking Department, through which all the rest of its business was done. The Issue Department passed all its notes over to the Banking Department, which then put into circulation through its customers such as were demanded of it, and held the rest as a reserve, together with a smaller reserve of gold sovereigns and lesser coins. The active circulation of bank-notes was thus smaller than the issue by the amount held in the Banking Department *; but in addition to the note circulation there was a large active circulation of gold coins.

* And also, if we wish to be precise, by the amount hoarded or held in reserve by the commercial banks. See page 39.

TABLE III

Total Coin and Bullion in the Bank of England at Various Dates

(From Feavearyear, *The Pound Sterling*)

	£000s	
1792	7,000	Before French War.
1796	6,000	Suspension of Cash Payments.
1809	4,500	Before Bullion Report.
1819	4,500	Before Restoration of Gold Standard.
1824	9,000	After Restoration of Gold Standard.
1844	15,250	Bank Charter Act.
1846	14,500	
1856	11,000	
1865	15,000	
1889	19,750	
1893	26,500	
1894	34,250	
1895	39,000	
1896	44,250	
1900	33,250	South African War.
1906	34,000	
1913	37,500	
1914	88,000	European War. [Gold sovereigns withdrawn.]
1928	159,750	Transfer of Treasury Notes to Bank.

TABLE IV

Gold Reserves of the Bank of England, 1913 and 1920–1939

£ Millions. End of Year

	Bank	*Treasury*
1913	35	
1920	128	28·5
1921	128	28·5
1922	127	27
1923	128	27
1924	129	27
1925	145	
1926	151	
1927	152	
1928	153	
1929	146	
1930	148	
1931	121	
1932	120	

TABLE IV—(*continued*)

	Bank	
1933	191	
1934	192	
1935	200	*Exchange*
1936	314	*Equalization Fund*
1937	326	170 (September)
1938	326	92 (September)
1939	279 (September)	367 (March)

TABLE V

U.K. GOLD AND DOLLAR RESERVES, 1939–1953

£ Millions. End of Year

1939	548	
1940	74*	
1941	97*	
1942	172*	
1943	322*	
1944	584	
1945	610	= $2,476
1946	664	= $2,696
1947	512	= $2,079
1948	457	= $1,856
1949	603†	= $1,688
1950	1,178	= $3,300
1951	834	= $2,335
1952	659	= $1,846
1953	899	= $2,518

When Great Britain restored the gold standard in 1925, there was no return to the use of gold coins, which had been withdrawn from circulation in 1914 and replaced by Treasury Notes; and a little later, in 1928, the Treasury Notes were replaced by Bank of England Notes for £1 and 10/-. Under the new conditions, the reserve of gold in the Bank had to serve as cover for a far higher proportion of the currency in circulation; for it had to cover the notes used in substitution for gold coins as well as the notes for £5 and upwards. But it was not necessary for the Bank of England to hold a proportionately higher gold reserve. The fiduciary issue was raised from under £20 millions to a normal £260 millions. Great Britain,

* Net figures after deducting outstanding liabilities to pay in gold for sterling.

† Gold was valued at 172/3d. per ounce fine up to June 1949, and thereafter at 250/-. In terms of dollars, it is valued throughout at $35 per ounce fine.

though again on the gold standard, was no longer using what was in effect a gold currency supplemented to a quite small extent by paper not covered by gold, but had adopted instead a paper currency backed by what would prove, it was hoped, a sufficient gold reserve to meet the claims actually made upon it.

There was a second change. It was no longer possible for anyone who pleased to go to the Bank and demand gold in exchange for paper money or bank deposits. That right was reserved, as it had really to be now that gold coins were no longer in circulation, to persons who wanted gold for certain recognized purposes. This meant in effect that the right to demand gold was limited to professional dealers or speculators, including of course bankers. As long as such persons could get it, and were free to send it abroad, the essence of the gold standard was preserved and the British currency was tied to gold as effectively as before, without the need to lock up nearly so much gold in unproductive monetary use. Gold, coined into sovereigns or kept in a bank vault, yields no interest or profit beyond what can be yielded by the paper that can be substituted for it. It is therefore more economical to use paper than gold, and to keep down the reserve held in gold to as little as is deemed enough to do what is needed of it.

Under the pre-1914 conditions, when most of the monetary gold in Great Britain circulated in sovereigns and the note issue played only a secondary part, the Bank of England's gold holding was quite a modest amount. In December 1913 it was £35 millions. In December 1925, after the restoration of the gold standard, it was £145 millions. The note circulation, on the other hand, was £35 millions at the end of 1913, and £391 millions at the end of 1925. Of the number of sovereigns in circulation in 1913 there is no exact account: it has been estimated at £115 millions. Gold coins constituted the greater part of the active circulation: a large proportion of the notes were in fact locked up in the vaults of the commercial banks. The Bank of England could always get gold coins from the Mint when it wanted them; and the Mint bought its gold as it needed supplies in the gold market, with cheques drawn on the Bank of England as the Government's banker.

The function of the Bank of England as guardian of the currency, under this system, was primarily to watch the movements of its own gold reserve, and to expand or contract credit supplies in accordance with these movements. The Bank could lose gold in either of two ways—an internal or an external drain. An internal

drain would mean that more gold money was being demanded for home circulation, or that gold coins or bullion were being drawn out of the Bank for hoarding. An external drain would mean that gold was being taken out of the Bank for export. The second of these drains was in practice by far the more important. There was little temptation to hoard gold under the pre-1914 conditions of monetary stability, and a demand for more sovereigns for internal circulation would be only one of many indicators of rising commercial activity.

An external drain was the phenomenon for which the Bank was always on the watch. There was more than one possible cause. It might arise because British people, or people operating in Great Britain, were buying a higher total value of things abroad than could be balanced by foreigners' payments for British exports, shipping and financial services and for the use of British capital invested overseas. In other words, British imports *plus* British exports of long-term capital might amount to more than British exports *plus* any long-term investments made by foreigners in Great Britain—'invisible' exports of shipping and financial services and dividends and interest on past investments abroad being included on both sides of the account. A lack of balance in this form might be mainly due to heavy imports or a fall in exports, to a pronounced increase in overseas investment, to a fall in shipping freight rates, or to any of a number of other causes. But a lack of balance could also be due to other factors. If, for example, there was a boom in the United States and interest rates there rose to high levels, persons who had previously kept their money in Great Britain might move some of it to America, not only for the purpose of buying long-term securities on the American stock markets but also for the purpose of lending it out temporarily at high interest to American speculators. There were short-term as well as long-term capital movements to be taken into account; and there were always professionals who made a practice of moving money about from country to country in pursuit of the largest return.

Any such movement, as well as any disequilibrium in long-term capital movements in relation to the balance of 'visible' and 'invisible' trade, might either send gold out of the country, or, if they acted in the reverse direction, send gold flowing in. The Bank of England would adjust its note issue to the amount of gold left in its possession by the combined operation of all these forces; but it would also endeavour so to act as to induce the commercial banks,

and the financial world in general, to accommodate their doings not merely to the actual flows of gold, but also to its anticipations of the probable trend of gold movements. The Bank of England had two main weapons for bringing about this accommodation—Bank Rate and Open Market Operations. Before 1914 the chief stress was laid on the former: nowadays, under greatly changed monetary conditions, it has shifted to the latter.

Bank Rate is technically the rate of interest at which the Bank of England is prepared to re-discount bills of exchange of certain approved types. But actually it is, or at all events was up to 1914, chiefly important as a signal to the entire financial world of the Bank of England's estimates and intentions relating to monetary conditions. A rise in Bank Rate was a signal to expect, and to act upon, conditions of monetary stringency: a fall was a signal that money could be regarded as plentiful in relation to the demand for it. When the Bank of England raised its rate, the commercial banks were expected not only to raise the rates which they charged to their customers, but also to go warily with the granting of new loans and to reduce their outstanding advances of short-term money. When the rate fell, the reverse processes were to be set in motion. And, in general, the expectation was that these influences were likely to be effective, even in the absence of other action by the Central Bank; for, as a rule, the commercial banks did with little hesitation what the Central Bank expected of them.

Under these conditions, the Central Bank's second weapon, Open Market Operations—the buying or selling of securities on the open market—could be regarded mainly as a weapon to be held in reserve, or as an instrument to be used occasionally for bringing about small adjustments which did not require action so drastic as a change in Bank Rate. If the commercial banks did not act promptly upon the advice given them through the medium of Bank Rate, the Bank of England could, by means of Open Market Operations, increase or decrease the amount of their 'cash' resources, in the way described earlier, and thus bring them into line—at any rate when what it wanted was a tightening of conditions. And the Bank could also, when it wanted to make a quite small adjustment of credit conditions, act directly on the commercial banks' resources by Open Market Operations, without altering Bank Rate.

In doing any of these things, the Bank of England up to 1914 regarded its role as mainly passive. Even if it sometimes acted in anticipation of events, it was not, in its directors' estimation, going

beyond doing promptly what would have to be done later on, and perhaps by its promptitude lessening the amount of adjustment that had to be made. It was guided, in what it did, almost entirely by the flow of gold into or out of the country: it regarded this movement of gold as the governing factor in determining day-to-day monetary policy, because it regarded its duty as that of preserving the gold standard and accordingly of keeping at the required level the value set on the pound sterling all over the world. If gold went on flowing out, the Bank would have to cut down its note issue to balance every ounce it lost, and in the end, when there was no more gold left to pay out, the country would be forced off the gold standard and there would no longer be anything to keep the pound firmly worth so many dollars, or francs, or marks, or crowns. For when those who wanted gold could no longer get it in exchange for British currency at a fixed rate, there would no longer be any automatic fixing of the pound's value in gold, or in other currencies which represented a fixed amount of gold.

It was therefore necessary, as part of what has been called the 'gold standard game', to take prompt measures to correct any tendency for gold to leave the country. This, under free trade conditions which did not allow any direct control over the volume of imports, or any beyond mere suasion over that of overseas investments British subjects chose to make or over the movement of short-term funds, could be achieved only by making the economic conditions such that the wish to take gold out of the country would evaporate. Higher interest rates would induce the owners of 'free' money to leave it in London rather than elsewhere: scarcity of bank credit would force down prices and costs, and would thus make British goods cheaper in relation to foreign goods, encouraging exports and discouraging imports: and conditions of 'tight' money would also discourage overseas investment. By these influences a gold drain could usually, before 1914, be fairly easily put a stop to; and the textbook theory of those days in the main reflected the actual and successful practice of the Bank of England.

It is true that this entire process was carried on with hardly any direct regard to its effects on employment and production in Great Britain. If, as a result of monetary stringency, factories were shut down and men and women thrown out of work, that was an unfortunate consequence for which the bankers did not accept any responsibility. The remedy, in their view, was plain. It was to cut costs, including wages, until prices had been brought down to

the level needed for the stimulation of exports and the resumption of profitable business, at a lower money-level, in the home market as well.

I have spoken earlier in this book of the way in which such enforced price-cutting under the orders of the financial authorities actually works out. It was tolerated up to 1914 because the adjustments which the Bank had to carry through in order to remain on the gold standard were usually fairly small, and the consequences therefore fairly small also. Great Britain, as the effective centre of the entire financial world, the market in which the gold from South Africa—the largest source of supply—was regularly sold, and the chief source of foreign investment of long-term capital as well as of short lending, was remarkably strongly placed. The gold standard was in effect a 'sterling standard'; and there was a good deal of room for manœuvre when things threatened to go wrong. But when the gold standard was put back into operation in 1925, conditions were already very different. The United States had supplanted Great Britain both as the leading 'surplus' country—that is, the country with the largest sums available for long-term foreign investment—and as the country most strongly entrenched, by a vast gold reserve, in a position to make its currency the effective partner of gold. The gold standard was no longer a 'sterling standard': it was coming to be a 'dollar standard'.

Moreover, the terms on which Great Britain returned to the gold standard in 1925 were disastrous. Taking the opportunity presented by a fortuitous and temporary parity, which meant an actual exchange rate with the dollar at nearly the pre-war level, this country returned to the gold standard *at the* 1914 *gold value of the pound sterling*. Very speedily conditions in America changed, so that the natural rate of exchange between the pound and the dollar was shifted to Great Britain's disadvantage. In restoring the gold standard, however, Great Britain had incurred an obligation to hold the dollar-sterling rate at a fixed level, or practically so; but it became clear that this could not be done without a very severe reduction of British prices and incomes. The attempt to enforce this reduction, largely at the expense of wages, was the main cause of the General Strike of 1926; and despite the defeat of the strike the pressure was not wholly successful in this field. In other fields it led to a growth of restrictive monopolies designed to hold up prices, and therewith to unemployment and under-employment of productive resources. The strain continued right up to the moment when

Great Britain was forced to abandon the gold standard again in the world economic crisis of 1931.

My point is this. Under the conditions which existed up to 1914 Great Britain was so strongly placed as to be able to a great extent to set the economic tone to the rest of the world, apart from occasional upsets due to speculative booms and crises in the United States. This power meant that on the whole a gold standard policy was broadly consistent with monetary conditions that suited internal British needs, and that the adjustments required on account of gold movements were not often so large as seriously to upset employment and production. On the other hand, after 1925 the gold standard worked in quite a different way, and the adjustments which the Bank of England felt itself called upon to enforce were on such a scale as to dislocate production and give rise to mass-unemployment.

Under these changed conditions, Bank Rate was no longer a sufficient weapon. It had, moreover, the disadvantage that, to the extent to which it did its job, it reacted on all types of transactions involving the use of capital or credit, and not only on those which it was really necessary to damp down in the interests of exchange stability. High interest rates, for example, increased the economic rents of new buildings, and this, as houses were urgently needed, meant higher public subsidies for erecting them. High interest rates damped down other forms of capital construction, and therefore checked the modernization of industrial plant. They were a factor in making business men more cautious than they would otherwise have been—though not, perhaps, to a great extent outside a few industries which are heavy users of capital. In general, in face of the 'stickiness' of money prices, they tended to damp down production, to check technical advance, and to react very seriously on those who could not hold up their particular prices by some sort of monopolist action.

Open Market Operations, which were also used on a much larger scale than before 1914, reinforced these effects. More money was needed to circulate the goods and services that could be produced, unless prices were sharply diminished; but less money was being made available, and money prices were not coming down fast enough to meet the needs of gold standard equilibrium.

This was still the situation when Great Britain was forced reluctantly off the gold standard in 1931. What happened then? The fall in the external value of the pound sterling immediately relieved the situation of the Bank, by making British exports cheaper to

foreign buyers and imports from abroad dearer to British consumers. Over and above this, imports were checked by the introduction of a tariff, and Great Britain's traditional adherence to Free Trade was at an end. The pressure on the sterling exchange was eased, because holders of sterling, no longer able to withdraw gold, hesitated to attempt to withdraw their money now that it could be exchanged only for a lower, and varying, amount of any other money into which they might seek to convert it.

In leaving the gold standard, Great Britain had abandoned fixed for fluctuating rates of exchange with the monies of other countries. It would have been possible to attempt to meet the crisis of 1931 with a single act of *devaluation*—that is, by fixing a new and lower gold equivalent for the pound. In that event, most of the same immediate consequences would have followed; but Great Britain would have remained on the gold standard at a lower parity. This was not done. The pound was not devalued: it was allowed to *depreciate*, and to find for itself a lower, but not a fixed, value in terms of other currencies, corresponding to the conditions of supply and demand.

At least, this was what happened at first. But before long people began to say that the Bank of England was behaving *as if* Great Britain were still on the gold standard, albeit at a lower parity. It seemed to be the Bank's policy to keep the pound worth about 70 per cent. of its pre-1931 gold value, and to continue to operate the old techniques, with only the difference that considerably more room was allowed for seasonal and other short-term fluctuations. This policy, however, did not last. In April 1932 the British Government established an Exchange Equalization Fund—a fund created by Government borrowing to be used for the purpose of checking and limiting fluctuations in the exchanges—especially in the dollar-sterling exchange, and especially in relation to speculative movements. The method of operation of the Fund was to buy or sell dollars, or other currencies, or gold, in exchange for sterling in such a manner as to offset forces which were threatening to alter the exchanges in ways which were deemed inappropriate. Now, by its very nature, a Fund such as this cannot stand out against a persistent and marked tendency for exchange rates to move either for or against sterling. If it did, it would run out of the money needed for continuing its operations. It would come to consist either all of sterling, or all of other currencies and gold. Accordingly, the purpose of the Exchange Equalization Fund was not to make the

long-term value of sterling in terms of gold or other currencies substantially different from what it would otherwise have been, but to reduce short-term fluctuations and to prevent speculators from upsetting the exchanges in the hope of reaping high profits for themselves. In these objects much success was achieved; and, as the Fund got into its stride, its size was increased and larger and larger use was made of it, especially for buying up and sterilizing gold which was brought to this country by foreign owners who were afraid of monetary upsets in their own countries.*

Meanwhile, in 1933, the United States itself was driven off the gold standard by the world crisis. But the American conditions were widely different from those which had prevailed in Great Britain in 1931. The United States went off the gold standard, not from fear of losing gold—the American gold stock was enormous—but in an attempt at once to push United States exports by making them cheaper and to force up dollar prices in the United States, where there had been a sensational price-collapse. This is not the place to discuss the theoretical basis, or the practical effectiveness, of this policy. What we need to observe is that the United States did not allow the dollar to find its own level, but *devalued* it to a new fixed level, taking power at the same time further to alter its value in gold, either upwards or further downwards, by similar definite executive acts. The United States, then, never left the gold standard in the same sense as Great Britain had left it in 1931. It only altered the dollar's gold value, and thereby affected its value in terms of other currencies. Actually, after this devaluation, the pound sterling, which had had an exchange value of nearly 328 cents in December 1932, was worth nearly 512 cents in December 1933. Presently the Americans set up an Exchange Equalization Account of their own; and thereafter the sterling-dollar exchange came to be in effect 'managed' jointly by the monetary authorities of the two countries.

Even between 1926 and 1931 it had been impossible for the Bank of England to hold that the gold standard was any longer working automatically, and that its essential role was one of passive interpretation of the trend of events. The directors of the Bank were, however, during this period trying to get back as nearly as they could to the old system. After 1931, when the gold standard had been given up, it was necessary to choose between an attitude of sheer passivity, which would have left the exchanges to fluctuate freely

* The fluctuations in the Fund's holdings of gold and dollars are shown in the Table on page 75.

from moment to moment, and a policy of deliberate management. The first of these policies would clearly have been disastrous. It would have opened the way to all manner of speculative excesses, and it would have exposed Great Britain to great and continuous upsets in the supply of means of payment as well as in the relation of British to other money. Some sort of 'management' had to be resorted to; and, as we have seen, there was at first a marked tendency to 'manage' the currency so as to imitate as nearly as possible what would have happened if the gold standard had still been operative at an altered parity.

Events in America, more than anything else, soon altered the actual working out of this policy. When President Roosevelt came into office at the worst point of the American crisis, his administration set to work to bring about a revival of economic activity by various methods, among which was an attempt to increase the active circulation of money. As the supply of money expanded in America—which it could do indefinitely without being brought up against any shortage of gold—it became possible to expand the supply in Great Britain also, without fear of provoking adverse reactions on the exchanges. There was no risk of a flight of 'free' money to America in search of profit: interest rates in Great Britain could be kept down without fear of the development of a shortage of funds. The policy of the Bank of England subtly changed. It began to encourage, in a modest way, a policy of monetary expansion.

Interest rates were kept low, as recovery from the worst of the world crisis set in. Under a régime of stably low interest rates, Bank Rate lost its position as an instrument of Central Bank policy; for the Bank did not want to upset things by altering its rates. Almost the entire emphasis shifted over to Open Market Operations as means of adjusting the resources of the commercial banks and thus of influencing the general supply of means of payment. Instead of using Bank Rate as a signal, and leaving the commercial banks to make the appropriate adjustments, the Bank of England regulated the monetary supply directly by adjusting the level of the 'cash' balances of the commercial banks.

These changes were not without their reaction on commercial bank practice. The commercial banks, taking their cue from the general loosening of the old orthodoxies, began to allow themselves more latitude than they had been used to do in raising a credit superstructure on the 'cash' foundation allowed them by the Central Bank. The old principle had been that, roughly, £1 of 'cash',

including commercial bank balances at the Bank of England, would bear £10 of credit in the form of commercial bank deposits. This ratio was still broadly adhered to, but with more elasticity than before; and the banks began increasingly to work in terms, not of a single ratio between 'cash' and credit, but of a more complex formula in which a distinction was drawn between credits of different kinds.

If we look at a commercial bank statement, we shall see that the liabilities, apart from the capital and reserves, consist of deposits, some on current and some on time-deposit account. The assets consist of (*a*) cash in the bank's own possession; (*b*) 'cash' in the form of its deposits at the Bank of England; (*c*) 'money at call and short notice', which consists of advances made from day to day or for a few days at a time chiefly to dealers in Treasury Bills * and bills of exchange, but also to stock exchange operators; (*d*) bills discounted, including both Treasury Bills and bills of exchange held by the bank itself; (*e*) loans and overdrafts to customers—chiefly business firms; and (*f*) investments, which are largely, but not exclusively, long-dated government securities. Now, these assets

* Treasury Bills are promises to pay in three months' time issued by the Treasury and sold in the money market for what they will fetch. They are like Trade Bills (see page 52) in that they are sold for less than their face value to cover the interest charge on the money borrowed by means of them for the period they have to run before they fall due for payment. That is to say, they are 'discounted'. The rate of discount of course depends on the prevailing conditions in the money market—especially on the amount of liquid money resources for which short-term interest-yielding investment is being sought. There are two ways of issuing Treasury Bills. The main way is by *tender*. The Treasury when it wishes to borrow money in this form (i.e. short-term money) offers for sale whatever amount it thinks fit and asks for tenders—that is to say, it asks prospective purchasers to say how much immediate money they are prepared to offer in exchange for each £1 to be paid to them three months later. The prospective buyers then make their 'tenders', and the Treasury accepts the best offers up to the amount for which it has asked. The second way of issuing Treasury Bills is through the 'tap', which means that Bills, instead of being put up to tender, are offered at a fixed discount to anyone who is prepared to buy them. This second method was introduced during the first World War. Among the purchasers of Treasury Bills are various government agencies which have at their disposal balances they do not need to spend at once. Instead of leaving these sums earning no interest, they can lend them to the Treasury, getting Treasury Bills in exchange. We shall come later to the place occupied by Treasury Bills in the financing of government expenditure, and also to the analogous Treasury Deposit Receipt, which was a second World War innovation of short-term Treasury borrowing from the commercial banks. See pages 211 and 215.

possess varying degrees of what the banker calls 'liquidity', i.e. ready availability in the form of cash. Cash itself is obviously a perfect example of liquidity, in this sense; and balances at the Bank of England are almost as liquid, in that they are convertible on demand and without notice into cash. 'Money at call and short notice' is also highly liquid: the banks can recall loans in this category at a day's, or at most a few days' notice, and can thus reduce their obligations without risk of loss. They can also in practice, by recalling them, replenish their supply of 'cash'; for the bill-dealers who find their commercial bank loans withdrawn will be driven to rediscount some of their bills at the Bank of England, and the cheques paid by the Bank of England for these bills will, on being paid in to the commercial banks, swell their 'cash' balances at the Bank.

Bills discounted are less liquid; for they may have as much as three, or even six, months to run. The commercial banks, however, usually prefer to buy bills which have already run the greater part of their course, and have only a short time left before they mature. The commercial banks make a practice of not re-discounting bills they have once acquired; and this method of buying chiefly bills already well advanced towards maturity gives their bill-holdings the liquidity they desire, without involving the risk that a change in the rate of discount may mean a loss. Such a risk they leave to the bill-dealers: the bills they hold are collected at full face value when they mature.

Advances in the form of loans and overdrafts to customers are much less liquid than bills. They are generally given for six months, and often in the expectation that they will be renewed. The manufacturer or trader cannot afford to operate on a basis of day-to-day or week-to-week loans. He must be sure of the money for the time it will take him to collect payment for his goods. He pays for this assurance a much higher rate of interest than is paid for shorter-term loans; and accordingly the less liquid advances are the more remunerative to the banks.

Investments are commonly regarded by bankers as their least liquid assets. Yet British Government securities, and indeed most of the securities banks hold, are easily saleable at any time. They are not, however, saleable for a fixed amount of money, unless the banker holds them until their date of maturity—if they have one—and this date may be many years off. Quick realization of them involves a risk of capital loss. The banks accordingly prefer either to hold them till they mature—which causes them to have a pre-

ference for relatively short-term securities—or at any rate to choose their own time for selling and not be hurried into realization at an unfavourable moment. This causes the bankers to regard such securities as 'illiquid', despite their ready marketability.

The rules on which the commercial banks, subject to some elasticity, now appear to work are these. They aim at keeping approximately 9 per cent. of the amount of total deposits in cash, including 'cash' balances at the Bank of England. This is known as the 'First Liquidity Rule'. Secondly, they aim at keeping approximately 30 per cent. of total deposits in fairly liquid form, including 'money at call and short notice' and bills of exchange or Treasury Bills as well as 'cash'. This is known as the 'Second Liquidity Rule'. The remaining 70 per cent. of their assets they distribute, according to the prevailing conditions, between 'Advances', i.e. ordinary loans and overdrafts, and 'Investments'. When business is active, advances rise and investments fall off: when business is slack, the reverse happens. The banks also feel free to allow some elasticity between 'cash' and highly liquid assets. If their holdings of 'money at call and short notice' and of bills are high, they may let their 'cash' fall below 9 per cent. If bills and short loans are scarce, they may increase their 'cash holdings' above 9 per cent. of deposits.

There is, then, a good deal of elasticity in the credit superstructure which the commercial banks feel entitled to raise on any given 'cash' basis; and this means that the control exercised by the Central Bank is by no means rigid. There is, however, always a limit which the commercial banks do not feel themselves entitled to pass; and there is always an inducement to approach this limit because 'cash' earns nothing, whereas the less liquid assets are on the whole the more profitable. This is not quite true, on the descending scale of liquidity described above; for loans and overdrafts are usually more profitable than investments in gilt-edged securities. The banks have therefore an inducement to lend to producers and traders as much as they dare, such loans being their most profitable outlet. If they lend less than they should in these forms, the explanation is caution and timidity, overcoming the appetitite for profit. Banking is in general so profitable a business that bankers are under no necessity of taking many risks in order to satisfy their shareholders' avidity for profits.

The commercial banks thus operate, with some elasticity of practice, on a 'cash' basis which is determined for them, broadly, by the Central Bank, chiefly through the medium of Open Market Operations. When a country is on the gold standard, the principal

factor which affects the Central Bank in deciding what the size of the 'cash' basis shall be is the supply of gold at its command. This statement, however, requires some qualification in the light of recent conditions. The United States, because of its creditor position and its excess of exports over imports, as well as of a tendency for 'refugee' capital to seek security by migration to America, was receiving even before 1939 so much gold that, if the augmented gold stock had been allowed to produce its full effect on the supply of means of payment, there would have been a gross inflation of credit and prices would have been driven out of hand. Accordingly, much of the gold imported into the United States has been 'sterilized' by various methods, and thus prevented from producing its effect. One such method has been to alter the legal provisions prescribing the 'cash' reserves to be maintained by the commercial banks. In America, such reserves are controlled by law, whereas in Great Britain the reserve ratio rests only on convention. The United States has not been strictly on the gold standard; but the *de facto* stabilization of the dollar in terms of gold has made conditions there resemble in many respects those which apply to gold standard countries. The American conditions are, however, absurd, in that no country has ever before had so vast a gold stock as to involve the ignoring of the available supply of gold in the fixing of internal monetary arrangements.

When a country is off the gold standard, and the freedom to export gold does not exist, there can be no fear of a drain of gold due to the withdrawal of gold stocks from the Bank by private persons. The attention of the Central Bank then comes to be fixed, not on gold movements, but on the fluctuations of the rates of exchange between the national currency and the currencies of other countries, or on the fluctuations that would occur if no steps were taken to prevent them. There is, under such conditions, no absolute reason for taking any particular rate of exchange as a standard to be aimed at. The monetary authorities, unless they have tied themselves down by international agreements, are free to select any rate of exchange as that which they desire to maintain, to lay down any limits they please within which fluctuations are to be allowed without any attempt to check them, and to alter the standard aimed at as often and as far as they please. In reaching their decisions, they will be torn between two objectives—that of adapting the supply of means of payment to internal needs, so as to secure the fullest possible employment of productive resources with the least possible

TABLE VI

Values of Certain Currencies in United States Cents, 1938–1953

		Average of Year				Value in 1953 as % of value in 1938
		1938	1949*	1949†	1953	
Canada	dollar	99·44	100·0	90·91	101·7	102·3
Switzerland	franc	22·87	23·17	23·16	32·0	101·9
Pakistan	rupee	36·42	30·22	30·22	30·22	83·0
Sweden	krone	25·14	27·82	19·32	19·33	76·9
New Zealand	£ stg.	393·3	403·0	280·0	280·0	71·2
Denmark	krone	21·76	20·84	14·48	14·48	66·5
W. Germany	RM. & DM.	40·16	30·0	23·81	23·81	59·3
Belgium	franc	3·380	2·282	2·0	2·0	59·2
India	rupee	36·42	30·22	21·0	21·0	57·7
U. of S. Africa	£ stg.	486·2	403·0	280·0	280·0	57·6
Australia	£ stg.	389·6	322·4	224·0	224·0	57·5
United Kingdom	£ stg.	489·0	403·0	280·0	280·0	57·3
Norway	krone	24·45	20·15	14·0	14·0	57·3
Egypt	£ stg.	501·5	413·3	287·2	287·2	57·3
Holland	guilder	54·95	37·70	26·32	26·32	47·9
Turkey	£ stg.	79·36	35·71	35·71	35·71	45·0
Finland	mark	2·145	0·7353	0·4348	0·4348	20·3
Yugoslavia	dinar	2·303	2·0	2·0	0·3333	14·47
France	franc	2·860	0·3076	0·2864	0·2857	10·0
Italy	lira	5·263	0·1739	0·16	0·16	3·04
Japan	yen	28·50	0·2778	0·2778	0·2778	0·975

* Before devaluation.

† After devaluation.

dislocation of the price-structure, and that of securing enough stability in the external value of the national currency to enable exporters and others engaged in foreign trade and the recipients of incomes from foreign investments to have as much assurance as possible in placing contracts, selling goods abroad, or estimating the value of prospective incomes from foreign capital holdings. They may also, of course, be affected by the Government's financial commitments, in these days when inter-governmental indebtedness is an important factor in the balance of payments. A debtor Government, equally with a commercial debtor, has to pay more in terms of its own currency if that currency comes to be worth less of the currencies in which the debts have to be paid off, or the interest met, or of gold. There may well arise a conflict between these objectives; and the monetary authorities will then have to compromise as best they can. The more a country depends on foreign trade and overseas investment, the greater will be the importance attached by its monied classes to the factor of exchange rates; the greater the volume of its production consumed at home, the more stress will tend to be laid on the need for adequate supplies of money to finance home industry and trade. The more a Government owes to foreign countries, in gold or in foreign currencies, the more reason it has for not wishing the value of the national currency to fall in relation to the currencies of the creditor countries, or of gold. It may be added that the more a country suffers from unemployment and seeks to escape from this curse, the greater will be the pressure on its monetary authorities for a liberal provision of credit facilities for its home industries.

There can be, then, no automatically fixed rule to which monetary policy must conform in a country which is off the gold, or some other fixed international, standard. The case must be one for decision on grounds of expediency, not for conformity to a predetermined rule. When the gold standard operated, there were critics who objected to it, and wanted to see it done away with; but, as long as it did operate, there was room for no more than minor differences about the credit policy that had to be pursued. As soon, however, as a country is 'off gold', there is room for much more difference of opinion. It will be a disputed point how much money is needed in order to sustain conditions of full employment, and there will be in addition disputes about the definition of full employment itself, and about the relative importance to be attached to maintaining full employment and to exchange stability. Monetary

policy is bound, under such conditions, to become a highly controversial matter; and the knowledge that this is bound to happen, and the fear of the results of it happening, are among the principal reasons why many financiers and financial experts clung to the gold standard as an ideal, and ardently desired to return to it, even when they recognized that it had disadvantages. These gold standard advocates were—and some of them still are—so sceptical of the power of communities to devise systems of monetary 'management' that would work well, or what they regarded as well, that they preferred an 'unmanageable' objective standard, even if it might involve from time to time a maladjustment of the supply of means of payment to the community's internal needs. They would sooner have unemployment, enforced by the rules of gold standard finance, than trust anyone who could be put in authority over the banking system to manage credit conditions sensibly and well. Such an attitude is quite intelligible on the part of bankers, who can usually make quite good profits even when industry and trade are deeply depressed. It is not so easy to understand when it is embraced by persons who stand to lose heavily as a consquence of business depression. When such persons do hold this view, their attitude is to be explained largely as a by-product of their hostility to state control over economic affairs, and is to be attributed to their recognition that, when day-to-day banking policy becomes a matter of acute controversy between groups and classes, it may not be long before political pressure is exerted to bring the entire banking system under political control.

In these days, however, though many financial experts still hanker after a return to the gold standard, or hope for the adoption of some alternative arrangement that will fix the relative values of the leading currencies so as to remove the matter from purely national control, most people in Great Britain recognize the impracticability, for the present, of any such commitment. The Americans do indeed exert a continual pressure for a return to full convertibility of national currencies and for the removal of the restrictions which are placed on payments across national frontiers. They can afford to do this, because the dollar is a scarce currency and they are in no danger of having deflation forced on them from outside; and they wish to persuade other countries to return to what they call 'freedom of exchange' because they stand for unrestricted capitalist enterprise and are opposed to state control wherever it restricts the opportunities of American capitalism. As against this, countries which are

in difficulties over their balances of payments—and in most cases short particularly of dollars—are not in a position to allow free convertibility, which would in effect leave their economies at the mercy of fluctuations in American business activity and liable to become the victims of both booms and slumps originating in the United States. These questions, however, will be better considered more closely later in this book.* They are mentioned here only because the support of the Americans for a return to convertible currencies gives to the European advocates of the older financial orthodoxies their main strength in combating the notion of preferring full employment to exchange stability as the first objective of monetary policy.

* See pages 332 ff.

IV

PRICE REGULATION—THE TRADE CYCLE—SPECULATION

A GREAT deal was written in the 1930s about the paradox of 'poverty in plenty'. Men were asking in growing numbers and with increasing vehemence why mass-unemployment and under-consumption were allowed to exist in a world technically equipped to produce abundance. In many cases, the complainants put the major part of the blame—sometimes the entire blame—for this paradoxical situation upon money. They alleged that the advanced countries, and indeed all countries, were suffering from gross mis-management of their monetary affairs; that there was somewhere a flaw in the money system which led to a persistent, or to a recurrent, deficiency of purchasing power; that men were the victims of 'gold standard finance' or, alternatively, of the 'flood of worthless paper'; that the monetary system was too little, or too much, 'managed' by bankers and/or politicians; and that everything, or at least most things, could be put right by well-designed and sweeping measures of monetary reform. Others more modestly asserted that monetary factors, even if they were not at the bottom of all our troubles, had at any rate been mainly responsible for the recurrent economic crises which have swept across the world ever since the capitalist system began, and that there was about money an inherent 'instability' which it should be the object of public economic policy to keep under control.

Both the diagnoses of what was amiss and the suggested remedies were diverse and numerous; and it would be quite out of the question, in a volume such as this, to examine even cursorily a tithe of the writing that was published on the subject during the period of economic instability between the two wars. All that is possible is to pick out from the welter of critiques, plans and proposals, a few key points of attention, on which many of the critics seized, and a few typical projects of reform.

It seems best to begin with those critics who have seen the root of the evil, not in money itself, but rather in the workings of the price system. It is, of course, a matter of general agreement that the extreme instability of prices in recent years has been a most upsetting factor for producers and traders in many countries and in many lines of business. Some of the projectors hold that this instability of

prices is to be attributed to the mismanagement of monetary affairs, and that accordingly the remedy must be sought in the field of monetary policy. Others, however, believe that the remedy is to be found rather in the regulation of prices, holding that price-changes set up undesirable reactions on the demand for money and that a stabilized price system would of itself induce a much greater stability in the sphere of monetary supply. These advocates of price-stabilization fall broadly into two groups—those who wish to operate mainly on the prices of particular goods and services of key importance, and those who propose action designed to steady the 'general level of prices'. I shall begin with the latter.

What is the 'general level of prices'? As far as the notion has any precision, it must refer to some sort of *average* of the prices obtained for particular things. In most countries there are nowadays certain series of index numbers by means of which an attempt is made to measure changes in the level of prices. The two best known and most widespread types are, first, the series giving index numbers of Wholesale Prices in particular countries, and, secondly, the parallel series measuring either Retail Prices of commodities or, on a somewhat broader basis, the Cost of Living. In index series of these types there is usually a single base year or month, or sometimes a base which is itself an average of several years or months. Average prices in the base period are taken as 100; and the index numbers for other years measure changes from this standard. Thus, the old Board of Trade Index of British Wholesale Prices stood at 176 in February 1946, as compared with 100 in the first half of 1939, just before the outbreak of war; whereas the Ministry of Labour's Cost of Living Index stood at 132 at the end of 1945, as compared with 100 at the beginning of September 1939. Examples of other index numbers are given in the accompanying tables.

Evidently, all index numbers must be based only on a selection of prices; for it would be out of the question to record and average all the prices actually charged over any period. Moreover, if price-changes are to be recorded over a period of time, care has to be taken to compare like with like. It would tell us nothing about the movement of prices for motor-cars to be informed that an Austin Seven cost £145 at one date, and a Rolls-Royce £3,500 at another. The quality of the things compared must be as far as possible the same at each date; and accordingly only standardized articles lend themselves to comparison with any degree of accuracy. This means that price-changes are much more difficult to measure for some

TABLE VII

Index Numbers of Prices, 1929–1945

1929=100	*Wholesale Prices*							*Cost of Living*		
	United Kingdom			*U.S.A.*		*Germany*	*France*	*U.K.*	*U.S.A.*	
	Board of Trade	*Economist*	*Statist (Sauerbeck)*	*Labor Bureau*	*Irving Fisher*	*Official*	*Official*	*Ministry of Labour*	*Bureau of Labor*	*Industrial Conference Board*
1929	100	100	100	100	100	100	100	100	100	100
1930	87·5	84·0	84·2	90·7	89·6	90·8	88·4	96·3	97·5	96·6
1931	76·8	70·2	72·8	76·6	74·1	80·8	80·0	89·9	88·7	87·1
1932	74·9	67·7	70·7	68·0	64·0	70·3	68·2	87·8	79·7	77·8
1933	75·0	68·2	69·8	69·2	67·1	68·0	63·6	85·4	75·4	74·8
1934	77·1	71·0	71·7	78·2	79·5	71·7	60·0	86·0	78·1	79·3
1935	77·9	74·1	74·1	83·9	86·2	74·2	54·0	87·2	80·1	82·1
1936	82·7	78·6	77·8	84·8	86·9	75·9	65·5	89·6	80·9	84·0
1937	95·2	89·3	90·0	90·6	94·2	77·2	92·7	93·9	83·8	87·7
1938	88·8	77·8	80·1	82·5	84·3	77·1	104·1	95·1	82·3	85·6
1939	90·0	80·3	84·3	80·9	84·0	77·7	108·6	96·3	81·1	84·4
1940	119·6	104·3	113·0	82·5	86·8	80·2	—	112·2	81·7	85·2
	First half of 1939 =100									
1940	140	139	144	103	105	103	—	121	101	101
1941	157	151	159	114	117	105	—	129	106	106
1942	164	160	169	129	134	107	181	130	118	116
1943	167	164	172	135	140	109	210	129	125	122
1944	171	168	177	136	142	110	243	131	127	124
1945	174	172	182	139	145	—	—	132	130	126

TABLE VIII

Index Numbers of Prices, 1945-1953

1948=100	*Wholesale Prices. General Index*				*Cost of Living*	
	U.K.	*U.S.A.*	*Germany*	*France** (1949=100)	*U.K.*	*U.S.A.*
1945	77	66	—	20	—†	75
1946	80	75	—	34	—†	81
1947	87	92	—	52	94*	93
1948	100*	100	100	89	100*	100
1949	105	95	97	100*	103	99
1950	120	99	94	108	106	100
1951	146	110	112	138	116	108
1952	149	107	114	145	126	110
1953	150	105	111	138	130	111

* New Index.

† Both 132 in terms of old index (1937=100).

kinds of things than for others; but, even where a high degree of standardization exists, there may be a large number of different standard articles belonging to a particular group. To measure one of them may not give any accurate gauge of price-changes affecting the others; and to measure them all may involve great labour. Moreover, as soon as we try to put together the results of two or more measurements of price-changes for particular things, a further problem arises. Are we to give each measurement an equal importance, or are we to attempt some sort of *weighting* in accordance with the relative importance of the different things? If there are a hundred times as many transactions in one commodity as in another, or a hundred times as much of it being bought and sold, are we, in making up our average index of price-changes, to give it a hundred times the *weighting*? And, if the relative importance of the two alters from one date to another, are we to alter the *weighting*?

These problems arise as soon as we attempt to measure the change in price within a single commodity group including different species or qualities. They arise again when we try to put together the indexes for these groups into any sort of combined index measuring changes over a wider field. Statisticians have various ways of resolving the difficulties. Take such a substance as wheat. There are many varieties

—hard Canadian, soft English, Argentine, Australian, and so on—and many sub-varieties within each variety. What the Board of Trade does, in arriving at its estimate of the change in wheat prices generally, is to pick out a few of the most important sub-varieties and ignore the rest. It does the same with other commodities, taking a larger number of varieties for the more extensively traded-in goods and a smaller number for goods of less importance in the total of trading transactions. In this way it arrives at a rough weighting of the relative importance of the commodities included in its list, by taking more examples of one than of another. By averaging, both by groups and over the entire range of goods, it then arrives at a series of group indexes—for cereals, meat, textiles, metals, and so on—and at a general index of wholesale prices covering the whole range of goods included within the scope of its study. This last is what is called the Wholesale Price Index, and is widely used as an indication of the general level of commodity prices apart from retail trade.

The Ministry of Labour's Cost of Living Index is made up in a somewhat different way. It was originally based, about fifty years ago, on a collection of household budgets gathered from individual working-class households and showing how these particular households then spent their incomes on different kinds of goods and services. From these budgets a selection was made of the more important items recurring in most of them, leaving out such things as beer and tobacco, which were consumed by some but not by all, and also such highly variable expenditure as doctors' bills, travel and transport, and most forms of luxury or semi-luxury spending. An average budget was then made up, showing the average distribution of the weekly expenditure among the various items—the main kinds of food, clothing, and household necessaries. The various commodities were then given *weights* in accordance with the composition of the average budget. Each month the Ministry of Labour collects from a large number of shops records of the prices currently charged for the various kinds of goods—as far as possible, for uniform qualities—and compares these prices with those current in the base period. A separate index number is thus arrived at, where necessary by averaging several varieties, for each group of commodities; and these index numbers are then brought together into a weighted average covering them all. Rougher methods are used to measure changes in rents and in a few other things; and these are also weighted in relation to the items already included. The final outcome is a

general index which purports to measure average changes in working-class costs of living. The old Cost of Living Index has in this case been superseded by a new Interim Index of Retail Prices, beginning in 1947, with a substantially altered weighting; but the broad principle remains the same.

Many other methods, used in compiling other indexes, could be cited. But these two are enough for purposes of illustration. Clearly, neither measures at all exactly what it sets out to measure. In the case of wholesale prices, it is in general much easier to find standard varieties of raw materials, such as wheat or cotton, or of semi-manufactures, such as pig iron or steel or cotton yarn, than of finished goods, which are apt to be much more diversified. Accordingly, index numbers of wholesale prices generally represent much more the price-movements of raw and semi-finished materials than those of finished capital goods or consumers' goods, and, as the prices of finished goods do not necessarily alter in proportion to changes in the prices of the materials of which they are made, the Wholesale Index may not accurately reflect either the price-movements of finished goods or the general average of wholesale price-movements for goods at all stages. Similarly, the Cost of Living Index may fail to reflect real changes in retail costs if the prices of goods not represented in it, or inadequately represented, move differently from the average prices of the things it does cover.

Such index numbers as these cover between them only a part of the current transactions which go to make up the total movement of prices. They omit altogether transactions in land, in stocks and shares, and in all classes of goods that are not current products of industry. They omit wages, salaries, and other payments which constitute incomes for the recipients and costs for those who pay them.* One or two attempts have been made, by bringing together the Wholesale and Retail Indexes, together with separate indexes for a number of these other things, to arrive at a more general index of all types of current prices. But the difficulties of both measurement and weighting are very great, and the results command little authority. We cannot at present measure changes in the general level of all prices: we can measure only certain wide groups of

* There are, of course, separate indices for wages in a number of countries—sometimes measuring changes in wage-rates and sometimes changes in earnings; but these indices are entirely separate from the indices of wholesale prices and cost of living.

price-changes, and even these measurements are by no means accurate. When, for example, several authorities compile Wholesale Price Indexes by different methods and with different weightings, quite wide divergences sometimes appear. In April 1943, on a common basis (January to June 1939=100), the three best-known British indexes stood as follows: Board of Trade, 167, *Economist* 165, *Statist* (the well-known Sauerbeck Index) 173.

If measurements of average prices are difficult within a single country, they are much more difficult when any attempt is made to apply them on an international scale. There are, indeed, certain goods which are traded in extensively in a world-wide market and are therefore likely, in the absence of restrictive combinations, to have much the same value everywhere, subject to differences arising out of tariffs or subsidies or differing costs of transport. But these commodities are relatively few, and they are of very varying importance in different countries. Their prices can no doubt be expressed in terms of gold or of the money of some one country which is taken as a standard, and the fluctuations of their average prices, thus ascertained, can be measured. Such measurements have their uses; but obviously any such calculation must fall a long way short of giving any indication of world price-movements as a whole.

Stabilization of the 'general level of prices' is usually advocated as a national policy, and its object defined as that of holding steady whatever internal measure of prices is deemed the most significant for the purpose. This generally means the Index of Wholesale Prices rather than that of the Cost of Living, partly because the Cost of Living Index is a good deal narrower in its scope, applying as a rule only to working-class costs, and partly because the end in view is as a rule stability in commercial dealings rather than in standards of life. What I am about to say applies, however, whatever index is used.

Any policy designed to stabilize an average presupposes fluctuations in the items of which the average is made up. If some prices fall, the average will fall, unless other prices rise to a counterbalancing extent. Price-changes for particular commodities may arise from any of a number of causes. The price of, say, leather may fall, either because there has been a technical improvement in tanning processes, or because hides have become cheaper, or because a monopoly which was previously holding up the price has collapsed or altered its policy, or because the demand has fallen off and manufacturers are trying to reduce their stocks, or because the wages of the leather-workers have been reduced. Hides may have become cheaper

either because an increased demand for meat has caused a larger number of cattle to be bred, or because wages have fallen in the stock-raising areas, or for any of a number of other reasons. The demand for leather may have fallen off because of changes in fashion, or the development of substitutes, or changes in the incomes of the consumers. So, through the whole range of prices of particular things, there are a host of causes which may lead to a change in the price of a particular commodity. Some of these causes will apply to a wide range of other commodities as well, whereas some will apply only to the commodity or group in question; and even causes which apply in some measure to most commodities will not affect all of them to the same extent.

If the general level of prices is to be held stable, any rise or fall due to a particular cause must be counteracted equally with any attributable to a more general cause. If it becomes cheaper, or dearer, for purely technical reasons, to produce coal or steel or cotton goods, action must be taken to offset the change in their prices by bringing about changes in the opposite direction in the prices of other kinds of goods. But why should the price of, say, boots be raised because the price of stockings has fallen? If, indeed, there has been a widespread fall, not traceable to technical causes affecting the costs of production, there may well be a valid reason for intervention to bring prices back to a higher level. But, even so, is there any virtue in aiming at the stabilization of the average level as shown by the Wholesale Price Index at any particular moment? If the aim is that of offsetting monetary causes of price-instability, while leaving technical forces to operate freely on the prices of particular goods, the 'general level' ought to be left unfixed, in order to avoid forcing particular prices up or down for the purpose of keeping the average stable.

This is the more important, because in any particular country there will be some prices which are much less amenable than others to any manipulation on a purely national basis. In the United States, for example, the prices of such bulk exports as cotton are determined mainly by international factors of supply and demand, and cannot easily be influenced by national action—that is, unless the Government fixes an artificial price, at which it agrees to buy from the producers, standing the loss, or reaping the profit, when it re-sells in the world market. If the prices of cotton and other world-traded materials and foodstuffs are tending to fall on account of world conditions, and if the accepted American policy is that of keeping

the general level of prices stable without buying up the commodities in question at an artificial price and then selling them at a loss, it will be necessary to force up artificially the prices of those things which are less subject to world influences. Instead of correcting the evils arising out of the fall in the prices of basic materials and foodstuffs, such a policy will make the position worse; for the farmers, while getting less for their own produce, will be compelled to pay more for the goods they need to buy. What is called the 'farmers' ratio'—that is, the relation between agricultural and other prices—will be worsened to the farmers' detriment; and the result will be seen in an increase of industrial unemployment owing to the farmers' reduced ability to buy. The next thing will probably be a clamour from farmers for subsidies to compensate them, not only for the fall in the prices of their own produce, but also for the artificially induced rise in the prices of the things they have to buy.

The position is less clear-cut in Great Britain; but the same conclusion holds good. If the prices of particular things are to be allowed to alter as the conditions under which they are produced change, there is no good reason for trying to stabilize the average of all these fluctuating prices.

Yet it is obviously a bad thing for prices to alter, not because the conditions of production or demand have changed, but for some quite irrelevant reason. It is bad for producers to work in the dark about the selling value of their products, and for consumers not to be able to anticipate, even within fairly wide limits, what they will have to pay even a little while ahead. Such huge fluctuations in prices as occurred between the wars and in 1951 were manifestly bad; and the proposal to stabilize prices is accordingly attractive to very many persons who have experienced the evils of instability.

What, then, of proposals to stabilize not the general average of prices, but the prices of particular kinds of goods? It is one of the advantages claimed for the cartels which have grown so powerful in recent years that they exert a stabilizing influence on the prices of the goods they control. So they do; but this stabilizing influence is much more commonly used to hold up prices against a fall than to check a rise. What happens where cartels are strong in a number of industries and weak or non-existent in others can be seen clearly in the price-history of the inter-war period. In Germany for example, under the Weimar Republic, separate indexes were kept for the average prices of goods controlled, and not controlled, by cartels. The two indexes diverged sharply; for the cartels were able to a

substantial extent to check the fall of the prices of their goods in periods of slump without losing their ability to raise them in periods of boom.

The moral, however, may not be that it is wrong to take any action to steady the prices of particular goods, but only that it is wrong to entrust such powers to cartels representing the profit-making interests in the trades concerned. It would, indeed, under any form of controls be manifestly unwise to stabilize the price of anything for ever, or for an indefinitely long period. But there is much to be said for stabilizing over short periods the prices of the main farm products, and perhaps of others, or at least of setting limits to their short-term fluctuations. There is much to be said for offering the farmer a firm price on which he can base his decisions about cropping, while reserving full freedom to alter the price, with due notice, as the conditions of supply and demand change. What must be insisted on is that price-fixing on these lines must not be left to the producing interests alone, but must be done by agreement between producers and consumers or, in the case of the major commodities, mainly between producing and consuming countries, with the power of the State in reserve where producing and consuming interests fail to agree. The position is most difficult where it is a matter between producing and consuming *countries*. The provisional International Wheat Agreement of 1942 was an embryonic attempt to create a controlling agency, representing producing and consuming areas, which would be capable of acting in such a way; and after the war had ended attempts to arrive at a workable agreement between the producing and the consuming countries were renewed. A draft Wheat Agreement drawn up in 1948 failed to secure sufficient acceptance; but the following year the first definitive agreement came into force. It rested on the principle of fixing basic guaranteed prices for stated quantities of wheat, the exporting countries undertaking to provide, and the importing countries to receive, certain quantities within the price limits laid down. The guaranteed maximum price was on a falling scale from year to year. The actual prices were not fixed; but the importing countries agreed to purchase the prescribed quantities of wheat at prices not less than the agreed minima for each year, and the exporting countries to supply these quantities at prices not exceeding the agreed maxima. This agreement ran its course until 1953: it was then renewed by nearly all the participating countries; but the United Kingdom refused to ratify on the ground that the proposed minimum prices

were too high. As the United Kingdom is by far the largest single importer, its rejection of the agreement was a serious matter. The British Government held that the United States, whose Government was committed to a policy of guaranteeing high prices to its home producers, was endeavouring unreasonably to unload a part of its commitment on the world consumers of wheat, and that the prospects of world supplies and costs justified a lower minimum price. The difficulties experienced in arriving at a generally acceptable Wheat Agreement illustrate the problems involved in such international bargaining. Nevertheless, there may be a big future for Commodity Agreements negotiated for particular classes of goods either by Governments representing both producing and consuming points of view, or by associations or groups acting under effective government supervision.

Stabilization of particular prices must, however, be only for limited periods, because costs alter as the conditions of production change, and a price appropriate at one time becomes either too high or too low as technique alters, or as it becomes necessary to enlarge or to reduce the scale of output under changing conditions of demand. No one, I think, would uphold a policy of stabilizing permanently the price of any single commodity: yet quite a number of persons seem to favour permanent stabilization of what is only an average of a number of separate prices.

Can we not achieve what is really aimed at by the advocates of stable 'general prices' if we (*a*) take the right steps to limit the fluctuations over short periods of the prices of those important commodities which are most subject to price-instability, and (*b*) take action to limit irrational fluctuations in the prices of all, or most, commodities, where these are traceable to general conditions of economic instability? Surely our object should be, not to stabilize the 'general level of prices', but as far as we can to prevent prices from fluctuating irrationally owing to circumstances which have nothing to do either with changes in the techniques of production or with changes in consumers' desires, as distinct from consumers' ability to pay?

If this is agreed to be a reasonable objective, the question at once arises: How are we to set about it? The answer to this question will necessarily depend on the view taken of the underlying cause of the kind of economic fluctuation which commonly goes by the name of the 'Trade Cycle'. If it is held, in a phrase coined, I believe, by Dr. R. G. Hawtrey, that 'the Trade Cycle is a purely monetary

phenomenon', or in other words that the causes of major ups and downs in general economic activity are to be sought mainly or exclusively in the realm of money, the prescribed course of action will also be monetary. If, on the other hand, the causes of the Trade Cycle are held to lie mainly or exclusively elsewhere, the remedies proposed will be different according to the causes assigned and the relative importance attached to them.

The purely monetary theory of cyclical fluctuation rests on the assumption that there is an 'inherent instability' in the supply of money. If, for any reason, the prospects of profit from expanding production are good, more persons will want to borrow more money in order to take advantage of them. Bankers, who have, within limits, the power of creating money, will wish to respond to these demands, because the effect will be to raise their own profits, and they will be able to take under the prevailing conditions a more favourable view of the credit-worthiness of would-be borrowers than they could if the prospects of profit were worse. The response of the bankers in providing more credit will for the time make the prospects of profit yet better; and the process of credit-creation and borrowing by business men will therefore tend to be cumulative. Presently, however, the bankers will approach the limits of their power to create further credits. Where a country is on the gold standard, these limits are set by the limits of the Central Bank's power to enlarge the 'cash' basis without imperilling the supply of gold to meet foreign drains: where there is no fixed standard the Central Bank's power is unlimited, except by such legal restrictions as the State may have laid down, but is in practice usually restricted by the Central Bank's unwillingness to allow the foreign exchanges to become adverse beyond a certain point. The stage is therefore reached when the Central Bank refuses further to enlarge the 'cash' basis on which the commercial banks rear their credits; and as Central Banks usually think it necessary at this point not merely to stabilize but actually to contract the 'cash' basis, the commercial banks have to institute a reverse process of credit restriction, which becomes cumulative in its turn. Every reduction in the supply of credit incommodes somebody, whose difficulties then incommode others. The prospects of profit not merely worsen, but look like worsening further. The number of would-be borrowers for *new* enterprise falls off sharply, and the total of borrowing is sustained largely by borrowers who want money not for new production but for holding stocks of which they cannot profitably dispose. Economic

activity comes sliding down as fast as it was previously mounting up; and as long as it is expected to fall yet further there is no incentive to expand. Current production falls below even the reduced level of current consumption due to the fall in incomes and employment. Stocks of goods are gradually worked off, until in the end they approach exhaustion at prices at which they cannot be profitably replaced. The point is reached at which prices are felt to have touched bottom and an increase of production to be certain before long. It then pays to get in early—to order new instruments of production and to produce fresh stocks of goods while costs are still low, in the expectation of being able to sell in a rising market. The wheel has come full circle; and the cumulative process of expansion begins again.

This is a highly abstract and theoretical account of the course of a 'Trade Cycle'. In practice, things never happen quite like that, because neither is any single country a closed system within which the internal forces of instability can work themselves out unaffected by what is going on in the rest of the world, nor is the world as a whole so integrated economically that we can study its economic history as if its division into national States were irrelevant. In practice, the signal for a reversal of credit policy is apt to be, not simply a feeling on the part of the Central Bank that the limit of permissible expansion has been reached, but some adverse conjuncture arising in another country, or in the world market as a whole. Again, the signal for expansion may be given, not by the running down of stocks or the belief that internal demand has touched bottom, but rather by some favourable factor manifesting itself in some other country, or in a general recovery of export demand. Booms and slumps are, no doubt, in these days in the main common to all the leading capitalist countries; but they neither start nor end simultaneously in all these countries, and events occurring, or policies followed, in any one country may give the signal for either depression or recovery elsewhere.

In general, there was throughout the past two centuries, or at any rate up to 1914, a powerful expansive tendency in the world's economy. This tendency was towards a continuous widening of the market, due both to the increase of population in the older countries and to the rapid opening up of new territories for settlement, as well as to the invasion of old but economically backward countries by the new techniques of production and transport of which the more advanced countries were the pioneers. This under-

lying expansive tendency was a powerful force in bringing depressions fairly speedily to an end; for it meant that fresh opportunities for profit-making were being continually presented. Only after 1918 did conditions in this respect appear to have significantly changed. The process of economic development was indeed continuing fast in the United States, in Japan, in parts of China and India, in Latin America, and of course in the Soviet Union. But the growth of population was undergoing a severe check in the more advanced countries; and in the United States there was no more free land and the restrictions on immigration were also slowing down the population increase. This last factor was reacting on many of the less advanced countries in which population was still increasing fast, by confronting them with a serious problem of agricultural overpopulation, no longer relieved by migration in search of better economic opportunities in the United States.

Thus, the influence of monetary instability in engendering depressions was no longer corrected, as it had been, by powerful underlying expansionist tendencies in the world economic system as a whole. In the 1920s and 1930s the Soviet Union's isolation prevented its expansion from stimulating expansion elsewhere. Depression in some countries, including Great Britain, tended to become endemic, instead of epidemic: there appeared the industrial problem of long-term unemployment and side by side with it the problem of 'concealed unemployment'—that is, redundant population on the land—in the peasant countries. But why, it may be asked, if the underlying tendency towards expansion was no longer present, did the credit system retain its instability? Why did credit still expand till it reached a point at which bankers saw fit to contract it? Why did it not settle down to a stability corresponding to conditions of 'medium' economic activity?

The answer is to be found largely in the peculiar conditions which existed in the United States. There, as we have seen, the 'frontier' no longer existed, in the sense that there was no more free land. Nor was population increasing as it had increased during the latter days of unrestricted immigration. Nevertheless, the American economy was still expansive, because it had vast unexploited resources at its command, great current power to produce, immense opportunities for taking advantage in its home market of the economies of large-scale production, and a big section of its population still living at a low standard of life quite out of harmony with the 'American standards' prevailing in the wealthier areas and

among the better-paid classes of industrial workers. In the 'twenties, the American state of mind was still thoroughly optimistic and expansionist; and the United States had emerged from the first World War so strongly placed and so wealthy, in a corporate sense, as to be able to take the lead in influencing the course of world economic affairs. Devastating in proportion were the effects when, in the early 'thirties, the American economy plunged suddenly into a depression beyond all parallel in its intensity and in the range of its social effects.

The causes of this depression it is not necessary to analyse at this stage. The relevant point is that the United States was placed, after 1918, in a position to lead the rest of the capitalist world either into or out of depression, and that the great American depression of which the first signs were plainly visible in the autumn of 1929 was the effective starting-point for crisis and mass-unemployment throughout the capitalist world. The American collapse reacted in particular on European monetary conditions. At first, in the hope of maintaining the gold standard intact, the banks in Europe set about a contraction of credit which, by lowering the prospects of profit, restricted production and reduced the volume of new investment. When these measures proved to be inadequate in face of the deepening of adverse conditions in the United States, the European countries were either, like Great Britain, driven off the gold standard or, like Germany, able to preserve it in form only by giving up the substance and resorting to drastic restrictions on the supply of foreign exchange and to special measures for the subsidization of export trade. Even before 1914, the United States had been the principal centre from which radiated the influences making for boom or depression, with Great Britain acting as the main agency in transmitting these influences to the world economy as a whole. After 1918, this key-position rested entirely in the hands of the United States, with the difference that, whereas previously it had on the whole transmitted favourable and unfavourable influences with an impartial hand, with the favourable influences predominating because of the rapid, though discontinuous, rate of economic advance, after 1929 it became a force operating much more readily to induce depression than prosperity elsewhere. Other countries could not resist the adverse reactions of sharply falling prices and demand on the North American continent; but in face of the high American tariff and the wide range over which the United States was self-sufficient in the supply of both foodstuffs and manufactured

goods, American prosperity was by no means so favourable a factor for other countries as British prosperity had been. The United States was, in fact, a *marginal* importer, producing a high proportion of the things it needed at home and varying very greatly its demands for imports as total demand rose or fell: so that the consequences of up and down fluctuations in the American economy reacted disproportionately on American purchases of foreign goods. In addition American willingness to invest abroad was a highly variable factor: so that American fluctuations had catastrophic effects on the supply of dollars made available to other countries for buying American goods.

In the 1920s, while Great Britain was first preparing to return to the gold standard and thereafter operating under it, the limiting factor on the supply of credit to British industry was not so much the available supply of gold as the desire to maintain a certain relative value between the dollar and the pound sterling; and this desire not merely set limits to the expansion of credit but involved an almost continuous policy of credit restriction designed to compress incomes and prices in Great Britain. Moreover, when boom conditions developed in the United States, the effect was apt to be that of stimulating British and foreign speculators to endeavour to move funds from London to America, in order to earn the high interest offered for available money and to get a share in the capital gains accruing from stock market speculation. Thus, whereas the effects of American depression were at once passed on to Great Britain, American prosperity, instead of loosening British credit, was apt to tighten it up, on account of the flow of funds to the American stock markets. As long as the Americans maintained a high level of investment in European securities, and thus provided in effect the funds out of which the return on their earlier investments could be paid, Europe could carry on. But the withdrawal of much of the American short-term money from Europe, for use in the stock market boom of 1928-29, together with the virtual cessation of new long-term lending of American capital, brought financial disorganization to the European countries and led up to the European economic crisis of 1931.

The passing of world financial leadership—in the sense of power to affect the financial affairs of other countries—into the hands of the United States introduced a fresh element of instability into world financial conditions, because the economic system of the United States was itself unstable in a very high degree. Thus neither in the 'twenties nor in the 'thirties did world finance settle down. European

conditions, including conditions in Great Britain, were liable to recurrent upsets owing to the march of events in the United States, as well as to those arising out of forces inside Europe. The 'Trade Cycle' was seen to be predominantly an American phenomenon, radiating outwards from the United States to other countries, and carrying the rest of the world in the wake of the extraordinarily erratic movements of the American economy.

This digression was necessary in order to make clear that the actual course of cyclical economic movements may diverge sharply from that described in the 'model' account given a few pages back. We can, however, recognize in this 'model' account certain underlying tendencies which, however they may be distorted or modified by the impact of other forces, are nevertheless at work in shaping the course of economic events. It is true that there is about the credit system, as it exists in all the advanced capitalist countries, an essential instability, any movement in the direction of prosperity for the seekers after profit stimulating further movements in the same direction, and any adverse movement stimulating further adversities. It is, moreover, true that upward movements are commonly brought to a dramatic end by a contraction in the supply of credit.

It does not, however, follow from this that the contraction of credit is the real reason why advancing prosperity does not go on for ever. It may be; but on the other hand the truth may be only that the bankers step in to enforce credit contraction *before* other forces which would have brought the boom to a catastrophic end have had time to exert their full effect. This is the version of what occurs by which the bankers themselves usually hold. They regard themselves as interpreters of the trend of real economic forces, and as insisting on credit contraction, not because they want prosperity to end, but because they want the inevitable decline in activity to come about in an orderly fashion, and not by way of a catastrophe. At a certain point, the boom becomes in their view unhealthy, and the speculative activities to which it gives rise need checking sharply. They intervene, not to bring disaster, but to limit its extent.

What, then, are the signs of 'unhealthiness' in the development of a boom? Most obviously, the growth of speculative activity, which is in essence an attempt to cash in now on the prospective profits of the future, estimated on the assumption of continued boom conditions. One mark of such speculative activity is that attention is directed away from the creation of new instruments of production to the buying and selling, at rapidly rising prices, of ownership

rights in the instruments already in existence. In other words, there is a stock market boom—accompanied, usually, by a land boom mainly in urban land values and by a boom on the produce markets. Speculators are buying productive assets on the assumption that their prices will go on rising in the anticipation of high future profits; and they are buying up stocks of commodities in the anticipation that their prices will rise further as the boom goes on.

A speculative boom has the effect of making prices rise without stimulating additional production of capital goods. It may develop at any point in the upward movement of the course of economic activity: indeed, there is a speculative element in all such upward movements, because the anticipation of rising prices is always one of the most powerful stimulants of recovery. Recovery has, under capitalist conditions, always a twofold character. It is partly a rise in the level of economic activity, and partly a rise in prices—each factor reacting on the other. If and when a stage is reached at which all the available resources of production are being as fully used as it is technically and humanly practicable to use them—that is, if and when the community reaches full employment of its resources *—clearly further additions to the supply of money or credit cannot be effective in stimulating further production; for beyond that point production of one thing can be increased only by reducing production of others. Any further credit supplied beyond this point *must* find an outlet in speculation: there is no other outlet left. But in practice speculative activity can take the lead long before the point of 'full employment', in this sense, has been reached. Even when there are large productive resources still available for use, and not being used, those who have money at command may prefer speculation in existing means of production to the creation of new ones; and as soon as that occurs, prices are bound to go rocketing up, with adverse effects both on the balance of trade and on the

* I here use the words 'full employment' to mean, not simply that there are as many jobs on offer as workers available to fill them, but that the total productive resources of land, capital and labour are being employed to the fullest practicable extent. This of course does not mean that every piece of land, every machine, and every worker is being used, but only that none—or almost none—of the factors of production are being left unused where they could be combined to advantage. There will remain parcels of land and factories which it is not advantageous to use because the labour their use would require can be better employed elsewhere; and there will also be some potential workers whose labour cannot be used because there is no demand for that particular kind of labour in the places where it exists and because it is not easily transferable to the places or

standard of living of those whose incomes are fixed in terms of money. The consequences are that on the one hand the Central Bank experiences pressure on its resources as imports rise and exports fall off, and on the other wage-earners, and any others who can, make demands for higher incomes in order to offset the rise in prices, and thus increase the costs of production further.

All this can and does happen even while unemployment continues to exist on a considerable scale, as it did, for example, in 1928-29 in the United States. If it be asked why speculators prefer to traffic in existing assets rather than to create new ones, the answer is, in part, that speculation is the quickest road to profit—for it is quick and easy to buy a share, but takes time, mind and effort to build an efficient factory—and partly that in a boom the different parts of the productive economy do not advance in step. High profits are being made in some branches of production while others are still depressed, and there may be surplus resources and labour in some branches of production even when there is acute shortage in others. So it was in the United States in 1929. Agricultural prosperity especially lagged behind, and there was surplus labour both in agriculture and in branches of industrial production which were out of adjustment to national needs. Thus speculators could do better in the way of profits—in the short run—by speculating in scarce resources than by investing in new enterprise; and there were real difficulties in the way of transferring the surplus resources to more hopeful fields. Accordingly, speculation got on top at an early stage; and, as soon as the speculators had taken the lead, the boom became 'unhealthy', because it was serving not to bring further resources into use, but only to increase prices and create fictitious capital values based on existing assets.

The worst thing about a speculative boom is that it is impossible to check it gently after it has got into its stride. If it is checked at all,

trades in which it could be used to advantage. This latter problem can be met in the long run by providing openings for employment in the areas where the surplus labour is; but this is bound to take time and will probably require deliberate planning. As for the factories and machines that cannot be used, this is usually a case of obsolete or obsolescent capital resources—i.e. it pays better to create new ones than to make use of the old ones at high cost. The case of unused land is different, because the supply of land is fixed and its productive capacity widely different from one parcel to another. There will always be some land that is below the margin—that is, on which it will not be worth while to expend labour and capital however high the total of economic activity may become, because it will be more advantageous to use these complementary resources elsewhere.

the effect is to expose the fictitious character of the valuations to which it has given rise: so that, instead of a gentle recession, there ensues a crash. The bankers in America had in the period before the stock market crash of 1929 to face a difficult choice. They were in no danger of a drain of gold, owing to the strong creditor position of the United States and the attraction of foreign capital to share in the profits of speculation. They could point to unused resources as a justification for further extensions of credit, in the hope of achieving 'full employment'. But, when credit was extended, it went, not to employing the unemployed resources, but straight to the speculative markets. Sooner or later, the inflated bubble of stock market values was bound to burst, and to bring the whole economy into crisis. The banking authorities were powerless to prevent this. They could either let it swell till it burst of itself, or burst it by credit restriction which, they knew, would precipitate the ruin of many essentially sound enterprises as well as of those speculators who had not 'got out while the going was good'.

If there had been no complicating factor of speculation, the banking authorities could reasonably have gone on expanding the supply of credit until a state approaching full employment of resources had been reached, to the evident advantage of the American people. But in practice the speculative factor always is present—most of all in the United States; and as long as credit can be diverted from use in expanding production to speculative uses, booms will always become 'unhealthy' and will carry with them the germs of coming crisis, long before the point of full employment has been reached. The moral, of course, is that the suppression of speculative activity, at any rate in its more dangerous forms, is a necessary condition of the pursuit of a credit policy designed to bring about the full employment of the available resources of production.

V

THE SUPPLY OF MONEY—IS THERE A 'TENDENCY TO A DEFICIENCY OF PURCHASING POWER'?

THE argument of the foregoing chapter may be summed up in the following conclusions:

1. There is no valid case for an attempt to stabilize the 'general level of prices', which is only an average of particular prices.
2. There is a case for attempting to stabilize, within limits and over short periods, the prices of certain essential basic commodities; but such stabilization must not be left to groups of producers, but must be settled between producers and consumers, either within a single country or through the Governments of producing and consuming countries.
3. There is a case for attempting to eliminate those fluctuations in the 'general level of prices' which are due to monetary causes, rather than to changes in the conditions of production.
4. There is, under the conditions of modern capitalism, an inherent tendency towards instability in the supply of credit, and changes in either direction tend to lead to further changes in the same direction, so that, up to a point, booms and slumps go on of their own momentum.
5. There was, in the nineteenth century, a persistent underlying tendency towards economic expansion, dependent on the colonization and opening-up of new areas, the growth of population in the advanced countries, and the supersession of obsolete methods by a spread of new techniques to more and more areas and industries. This tendency largely ceased to operate between the first and second World Wars in face of the decline in population increase in the more advanced capitalist countries, the closing of the frontier in the United States, and the consequent appearance of 'concealed unemployment' in the peasant areas.
6. These changes, combined with Great Britain's loss of world financial leadership, aggravated the key influence in causing boom or depression throughout the capitalist world exerted by the United States, and thus added to the instability of world economic conditions.

7. The predominance of speculative factors in the American economy caused booms to assume an 'unhealthy' character in the United States long before a condition of full employment had been reached, and confronted the American banking authorities with insuperable difficulties in the way of a satisfactory management of credit supply.
8. The combined effect of two world wars has been to transfer the centre of world finance from Great Britain to the United States much more completely than this had occurred between the wars. The gold standard has become in effect a dollar standard, and dollar shortage has become a ruling factor in the monetary and economic policies of the rest of the capitalist world.
9. Although the United States has made immense economic progress since 1939 and has not suffered from any further crisis comparable with that of the 1930s, it would be premature to conclude that the factors making for instability in the American economy have been overcome. Moreover, even relatively small changes in American economic conditions or policy can now have very large repercussions on the economies of other countries.
10. The pressure exercised by the Americans for a general return to convertible currencies confronts countries which are short of gold and dollars with the prospect, if they were to comply with the American demands, of laying their economies open to almost entire dependence on the fluctuations of American business and economic policy.
11. Such dependence would make it impracticable for countries to pursue policies of full employment in face of any serious recession in the United States.
12. Even apart from this factor, it is not practicable to expand credit up to the point required to achieve full employment unless speculative influences can be prevented from intervening before full employment has been reached on such a scale as to make a crash in fictitious values unavoidable.

Some of these propositions were touched on only cursorily in the previous chapter. They will be considered more fully in subsequent chapters.* The discussion from which they emerged began with an

* See Chapters XV-XVIII.

examination of proposals to stabilize prices as a means of bringing about conditions of monetary and economic stability. We have had to reject the remedy of price-stabilization in its more comprehensive forms; but it has been allowed that the instability of prices has been greatly aggravated by monetary influences, which ought to be brought under better control. The question that now arises is that of the form which this control ought to take.

This brings us directly to a second group of reformers, who believe that the appropriate remedy lies in stabilizing, not prices, but the supply of money. According to this school of thought, the evil of monetary instability arises out of the power resting with the banking system—in effect, mainly with the Central Banks—to create or annihilate money almost at will, subject only to such restrictions as are imposed by legal requirements about reserves. These requirements, it is pointed out, may be quite ineffective where, as in the United States, the available supply of gold is in effect unlimited, or where they are so elastic as to make the supply of currency, in effect, merely respond to, and not govern, the supply of credit through the banks.

The advocates of a stabilized monetary supply differ among themselves on secondary points. Some of them wish to fix the supply of money absolutely, for good and all, whereas others wish to vary the supply in accordance with changes in population (a fixed supply *per head*) or, over long periods, by occasional adjustment to changes in money-using habits. They are united in wishing to take away from the banking system all power to vary the supply of money over short periods.

It is often difficult to find out exactly what these reformers mean by the 'supply of money'. If they mean only the amount of coin and bank-notes, is it not evident that the banks would remain free, even if the supply of cash was fixed, to vary the supply of credit within the wide limits left open to them? The only result achieved would be that of preventing the amount of bank-notes from being affected by the inflow or outflow of gold. This would leave the Central Bank free to regulate credit conditions by open market operations much as it does now. As this is clearly not what is meant, it is to be presumed that the advocates of a stable supply of money wish to stabilize bank credit as well as currency. But how is this to be done? Are the commercial banks to be compelled to lend out always an equal amount to their customers, irrespective of their credit-worthiness or of their will to borrow? It would be easy

enough to impose a maximum limit on the total of bankers' loans; but it is not easy to see how bankers could be compelled always to lend up to this maximum. The additional finance which is at present available during an upward movement of economic activity would be effectively cut off; but the protection against a downward movement would remain as inadequate as it is to-day.

Of course, much would depend on the initial level taken for stabilizing the supply of money. If the level were that prevailing during a boom, the check placed upon expansion would be proportionately small; but if the supply were stabilized at the level existing at a period of depression, a very strong obstacle would be put in the way of recovery, which would have to be brought about, not merely without a rise in prices, but to the accompaniment of a fall. Even if the Quantity Theory of Money lacks precise validity, there is enough truth in it for that to be unavoidable. An increased volume of transactions could be financed without an increased supply of credit only at falling prices.* This, of course, assumes the permitted quantity of credit to be actually in use at the time of fixing the level: if some of it were not there would be room, without a fall in prices, for such expansion as the unused margin allowed.

It is not easy to see why stabilization of the volume of money should find favour with monetary reformers in these days. If this country had been suffering from a succession of runaway booms, it would be easy to understand why reformers should lay stress on the need for checking the power of the banking system to create means of payment out of nothing. But, so far from this having been the case, Great Britain, over the whole of the twenty or so years before the outbreak of war in 1939, had no major boom and never came near to a condition of full employment. One would expect British monetary reformers to have been more intent on enlarging than on restricting the supply of credit; and so, of course, most of them were. The desire to restrict the supply of money, as a first object of financial policy, was found rather among economists (including refugee economists) who were still haunted by the memory of the runaway inflations which occurred in a number of European countries after the first World War. In those inflations, large numbers of persons who lived on fixed incomes (including professors of economics) found their standards of living suddenly cut away. They became so acutely conscious of the evils of inflation as to hold the evils of deflation of relatively light account. Mastered by

* Increased 'velocity' could not do the trick alone.

the fear that inflation might occur again if the creation of money were left in the hands of either banks or Governments, they wanted above all else a binding rule that would tie the hands of both; and the absolute fixing of the supply of money seemed to provide the easiest answer.

It is not, however, a satisfying answer; for it involves that, broadly, as the volume of production increases, prices must be forced down continually, unless ways can be found of economizing in the use of money and thus making any given supply go further. Doubtless, this is what would happen if the stabilizers had their way and the supply of credit were unalterably fixed. Just as the banks by means of the deposit and cheque system found ways round the currency restrictions imposed by the Bank Charter Act of 1844, so in time they and the business community generally would find ways round a restriction on the volume of bank advances. But it might take a long time to find this way round, and in the meantime the effects would be serious.

For it would be necessary under the assumed conditions for prices to fall, not only so as to match economies in the real costs of production, but beyond this so as to offset all increases in output, to whatever causes they might be due—or, of course, all increases in output per head of population, if the supply of credit were fixed at so much per head. Such a rule could not but check the rise in production, by lowering the inducements to produce. It would operate restrictively, not only to the extent of reducing prices, but also to the extent of causing fewer resources to be employed and fewer goods produced.

This, surely, is not the kind of remedy we are looking for. We want to find ways of maintaining, not of hindering, full employment; and it would be altogether too much if, in taking measures against runaway inflation and speculative excess, we were to be led away into actions which would make depression endemic and deprive us of all hope of preventing a recurrence of serious unemployment. That the power of banks to create money may need regulation can be agreed, especially in the sense that steps need to be taken to prevent credit from being used to finance speculative operations rather than an extension of productive activity. But that we should be invited to surrender altogether the right even of the community itself to vary the supply of means of payment is surely nothing short of absurd.

We can come now to those groups of monetary reformers whose

minds have been set not on reducing the possibilities of monetary expansion but rather on increasing them. First in this group come the schools of thought which have urged that the supply of money and credit should be based on the available supply of productive power, and should advance *pari passu* with increasing productive capacity. This type of proposal has a long history behind it. Thomas Attwood and others urged something very like it after the Napoleonic Wars, when falling prices were exerting a powerful depressing influence and unemployment was rife, as it was after 1918. It has always found favour, especially in periods of depression, with large bodies of relatively small-scale employers and traders, who, having for the most part but scanty reserves of their own to fall back upon, have much less power than most of their bigger competitors to last out through periods of depression, and are the loudest in asking why their power to produce useful things cannot be married to the clamant need of the people for these very products. These smaller firms are usually of opinion that the bankers mete out to them less favourable treatment than to the big firms when money is tight: they want to be helped more when times are bad and also to be accommodated with cheaper credit in both bad and good times.

What does the proposal to base the issue of credit on productive power, rather than on actual production, really mean? It cannot mean that anyone who possesses machines and can hire labour ought to be accorded, as of right, enough finance to allow him to put his machines to work. It cannot mean this, because his machines may be so obsolete that they would not be worth using however high the level of demand might be—i.e. it would be better to build new ones and scrap the old—or his machines, even if not obsolete, may be redundant, because there is no possibility of enough demand for the particular things they are fitted to produce to make their use worth while. 'Full' employment must mean *balanced* employment in making different kinds of goods in relation to a balance of demand. It cannot mean that every machine is to be employed—or what obsolete machine is ever to be scrapped?

In effect, the notion of making credit available in accordance with the available supply of productive power has no valid meaning except in relation to a formulated *plan* of production designed to achieve the largest practicable total use of the available resources. It implies that no man and no machine is to be left idle if its employment would add appreciably to the total social product and would not take away labour or materials from more useful forms of

employment. It does not confer a right on any producer to receive credit; but it postulates that the aim of the plan is to be full employment of all the resources that can be combined so as to achieve maximum production.

In this sense, the proposal to make credit available to finance all operations which are embraced within the scope of the national plan of full employment is valid. But it remains an open question how large this supply of credit will need to be. It cannot be taken for granted, as it often is, that the supply must be enough to finance full employment at the existing level of prices for an indefinite period. Increased output for a 'fully employed' market will make it possible, in many instances, to reduce production costs; and such instances should greatly outnumber before long those in which a rise in output involves higher costs, even at the margin of production. If, with a system of private enterprise, credit were to be issued under conditions of full employment on the assumption of unchanged prices, windfall profits would soon make their appearance on a grand scale. The supply of credit required is that which will, on the whole, give just sufficient inducement to keep resources in employment at the desired level; and this supply will vary as the costs and conditions of production change.

Subject to the reservations already made, we can, then, accept the notion that the supply of credit ought to correspond to the available supply of productive power, while insisting that such a policy can be applied practically only as an element in a planned system of production.

At this point, however, we are confronted with a school of monetary reformers who maintain that, under the present system, no amount of credit that can be made available will bring about conditions of full employment, because there is in the 'price system' a fatal flaw which prevents the supply of purchasing power from being ever equal to the costs of production, and thus continually engenders business losses and bankruptcies and throws men out of work in an endeavour to redress the balance.

One's first inclination in answering those who advance this view is to accuse them of proving too much. If this 'flaw in the price system' really exists, how does it come about that we are not much worse off than we are, or that slumps ever end? The most familiar form of this critique of the price system has often been summed up in the conclusion that 'A cannot buy A+B'—when A is the purchasing power in the hands of the final recipients of income, and

A+B is the sum of the costs of production, including both wages, salaries, fees, rent, interest, and profits and payments to other businesses for materials, transport, insurance and banking services, and any other 'costs' which do not immediately represent spendable incomes in the hands of the recipients.

But why should A buy A+B? There is no need for B—i.e. the costs which do not represent direct income payments—to be covered by A. The flour and the fuel that go into a loaf of bread do not need to be paid for out of anybody's income. They are paid for by the baker, either out of his own working capital or out of a bank advance, which can be replaced as soon as he gets paid for the bread. The same is true of the wages which the baker pays out to his journeymen. They are paid out of working capital or bank advances till the bread is paid for, and then the capital can be replaced, or the loan liquidated. True, the journeymen's wages immediately become incomes in the hands of the recipients, whereas the sums paid to the suppliers of flour and fuel do not. But, if we analyse what happens to these latter payments, we shall find a part of them being paid out in wages, salaries and profits, or in rent or interest, to other recipients of income, and another part being paid over to corn-dealers or farmers, to colliery-owners or oil-suppliers or electricity concerns, in just the same way as the baker paid the miller and the coal-merchant. These sums in their turn will break up into 'A' payments to recipients of incomes and 'B' payments to intermediaries; and so on until we come to the primary sources of supply. From these, in turn, will lead a new chain; for the primary suppliers will be buying machinery and fuel, and paying charges for insurance and banking. It would be an endless process to analyse all the successive stages; but it is easy to carry the analysis far enough to show conclusively (*a*) that the 'B' payments resolve themselves ultimately into 'A' payments, which are available for buying all the finished goods which are on the market, and (*b*) that the 'B' payments can all be liquidated out of the 'A' payments, provided that time is allowed for the receipts to come in.

In an Appendix which appeared in previous editions of this work, I tried to make this plain by means of a Table and of a fuller explanation than I had room for in the text. This I have now omitted, in the hope that the shorter explanation is by now enough. I must, however, proceed to consider certain more refined forms of the 'A+B' argument. Some of those who advance this argument agree that there is no need for the final recipients of incomes to have a

purchasing power large enough to buy both the final and the intermediate goods—which would mean buying the same things a number of times over, at successive stages of production and distribution—but still contend that *some* of the 'B' payments never do resolve themselves into 'A' payments, with the result that, as all the 'B' payments must be covered if the final goods are to be sold at remunerative prices, the recipients of incomes are still left without enough money to buy all the goods on the market at such prices. The 'B' payments about which this allegation is most often made are banking charges and sums passed by businesses into depreciation or profit reserve accounts.

Take first the question of banking charges. Banks, and we may add insurance companies, are like other suppliers of intermediate goods and services in having costs to meet and dividends to pay. A part of the sums paid for their services goes out directly in wages, salaries and dividends, and constitutes direct income just as much as the similar payments made in any other industry. It is no doubt true that, over and above these income payments, both banks and insurance concerns usually charge highly enough for their services to be able to make substantial appropriations to reserve. But such reserves are in precisely the same position as reserves belonging to other businesses, and can be considered under that more general head.

Allocations to depreciation and obsolescence accounts are destined normally to be spent on the purchase of new and up-to-date machinery and plant. If they are so spent, fairly soon after the allocation has been made, they differ in no essential respect from other sums spent on investment in capital goods. Capital goods, equally with consumers' goods, need, in their finished forms, to be covered by money available for spending. The sums paid by firms into their depreciation and obsolescence accounts cover the purchase of the capital goods needed for replacements. The only special feature about these sums is that firms are under no obligation to spend them at any particular time. They can be 'hoarded', with a view to being spent later; and if they are hoarded, so much is subtracted from current expenditure on currently produced goods, and a deficiency of purchasing power appears. This, however, is not peculiar to sums paid into depreciation accounts. 'A' payments, that is, direct incomes, can also be hoarded; and, when they are hoarded, a precisely similar deficiency appears. We can, therefore, best come back to this question when we are considering the effects of hoarding over a wider field.

What, then, of allocations to reserves—that is, profits not paid out as dividends, but retained in the business? When prices are rising, some part of these reserved profits may be needed, over and above the sums assigned to special depreciation or obsolescence accounts, to cover the higher costs of *replacing* worn-out or out-of-date equipment as distinct from providing additional or improved equipment capable of yielding an increased output. Sums so used are in effect allocations to replacement, and are accordingly covered by the argument of the preceding paragraph. Deducting them, we have left the reserves that are available for new investment—that is, for the provision of additional productive resources. Such sums may be invested in the expansion of the firm's own equipment, or in the new share or loan capital of other enterprises, or in existing shares or other securities of any sort. If they are invested in any of these ways, they do not differ significantly from sums paid out in dividends, and similarly invested by the recipients. They can no doubt be hoarded, and not invested at all; but so, as we have seen, can sums paid out as incomes. Unless they are hoarded, there is no reason to suppose that their being paid into reserve funds will result in any deficiency of current purchasing power. If they are hoarded, such a deficiency will result, but in no different way from deficiencies arising on account of the hoarding of any other form of spendable receipt. This conclusion applies to bank and insurance reserves equally with others. There is no more reason to suppose that banks will hoard idle reserves in such a way as to derive no income from them, than to suppose that other business men will behave in this fashion. This is not to say that reserves will not sometimes be hoarded, just as ordinary incomes are hoarded, but only that bankers have no special proneness to hoard their reserves. To the general question of hoarding and its consequences I shall come back later on.

It appears, in the light of the foregoing argument, that the contention that there is a 'flaw in the price system' leading to a continuous tendency towards a deficiency of purchasing power rests on a fallacy. There is no such *continuous* tendency. It is, however, perfectly true that there is no assurance of the purchasing power actually expended, or of the new purchasing power based on incomes generated in the course of production in any one accounting period, such as a year, corresponding to the total costs (including profits) incurred over the same period. There are a dozen reasons why no such correspondence can be assumed. In the first place, there will be at the beginning of any such period goods in stock and in

process at all stages of production, and during the period stocks will be drawn upon and renewed. Stocks at the end of the period may not stand at the same total level as stocks at its beginning; and the goods made during the period may incorporate materials and components made at a time when costs were widely different from what they have since become. Secondly, there is, as we have seen, no reason why the flow of payments into and out of depreciation and obsolescence accounts should balance over any particular accounting period; nor is there any reason why appropriations to reserves should balance over any particular period investments out of reserves. There is accordingly every possibility of a divergence in any particular accounting period between the 'cost-*plus*-profit' prices of the goods and services offered for sale during that period and the disposable revenues made available over the same period to recipients of income for buying them. But there is no good ground for expecting this divergence to be more in the one direction than in the other, or to lead to any lasting deficiency, unless money needed for purchasing current output is hoarded, not merely for a time, but permanently. Apart from such hoarding, the divergencies will cancel out over a longer period; and if, in the interim, bank loans are available for making temporary deficiencies good, there is no reason to expect any serious evils to arise from this cause, unless hoarding assumes large dimensions—a possibility which we shall have to consider at a later stage.

Are we then to come back to the old, orthodox belief that every act of production automatically creates a market for the goods produced, so that no deficiency of purchasing power need ever be feared? This has been for well over a century a cherished tenet of economic orthodoxy, known as J. B. Say's *théorie des débouchés*, or 'Market Theory', and has been used on many occasions to confute those who have attributed the development of economic crises to 'over-production'. General over-production, on Say's showing, is impossible, though there can, of course, be over-production of some goods in relation to others. It is impossible, because incomes are generated in the course of production, are in effect shares in the product, and at the same time constitute the costs of getting things produced. Every cost is, in the final analysis, an income as well as a cost; and accordingly the incomes available for buying goods and services will always be equal to the cost of placing them at the purchasers' disposal. It is agreed, of course, that there will be, when any single stage of production or distribution is looked at in isolation

from the rest, a large number of elements in cost which do not appear to be balanced by incomes paid out to those entitled to receive a share in the proceeds of this particular stage of production or service. The incomes accruing to the makers of any class of goods will always be much less than the sum needed to purchase their products, because a large part of the costs of production will consist of payments made for materials, fuel, transport and other things used up in the process. This, however, as we have already seen, does not invalidate Say's Law; for we have only to carry the analysis far enough to find these 'B' payments turning into 'A' payments at other stages of the total productive and distributive effort. If we pursue the quest to the very end, we shall find that all costs have been accounted for, by being paid out at some stage to recipients who can spend them on either capital goods or consumers' goods or services. Among these recipients will be the State and other public authorities, which receive rates and taxes levied on economic processes or goods, and are able to spend the sums accruing to them on the public services. In effect, every payment will be found to resolve itself finally into somebody's disposable income—either that of an individual or that of some corporate or collective body, which will have it to spend on some of the things to the cost of which it has contributed.

Of course, to say that all these cost payments resolve themselves finally into disposable sums available for purchasing the product of industry, in the widest sense, is not to deny that the total money sum of the transactions requiring to be financed will far exceed the sum of the disposable incomes. Precisely what credit is chiefly needed for is to finance the excess; but the credit used for this purpose is self-liquidating. It confers the use of means of payment over a limited period of time, at the end of which the advance is paid off: it does not destroy the purchasing power so used, but only transfers it. The question of the amount of money needed to finance all transactions—intermediate as well as final—is entirely distinct from that of the *income* needed to purchase the total final product at a price sufficient to cover its cost.

The defect of Say's theory is not that it is formally untrue—for it is not untrue in a formal sense—but that it can be so easily misapplied. To begin with, it is true just as much at one level of production as at another. It is as true when half the nation is out of work as when all the available resources are fully employed. It would be as true if no one were in employment and nothing at all

were being produced. It demonstrates, no doubt, the impossibility of general *over-production* in a closed economic system; but it entirely fails to demonstrate the impossibility of general *under-production*. It proves that unemployment cannot be due to general over-production; but it entirely fails to prove that unemployment will not exist. How indeed could it prove any such thing, when plainly unemployment has so often existed, on a serious scale, and has sometimes reached catastrophic proportions, in all capitalist countries?

Say's Law does not prove that any producer who makes goods or services available will automatically find purchasers for those goods or services at prices which will cover their costs. It does not prove to any particular capitalist firm that it will pay to use its productive capacity to the full—in preference to leaving some of it idle. It does not prove that more profit cannot be made by some people by producing less rather than more. All that it does prove (subject to reservations to which I have drawn attention already and to others to which I shall draw attention later) is that, *if* all productive resources are fully employed, there need not appear any deficiency in the supply of purchasing power available for buying the products. The assumption made in Say's Law is, of course, that all the purchasing power that is made available will be actually spent. It does not deal with the effects of hoarding, but only with the sums made available for spending in the course of the productive process. Within these limits it is valid.

One reason why wrong use has often been made of Say's Law is that the classical economists who adduced it were in the habit of assuming, quite apart from it, a condition of full employment. They set out, in their theoretical analysis, from an assumption of perfect fluidity of both labour and capital resources, so that any element in either could be shifted instantly at need from one use to another. They assumed that labourers and capitalists would always take what returns they could get, rather than abstain from production, that there would be unrestricted competition among them, and that, as a consequence of this complete fluidity of everything, there could be no unemployment. They were not, of course, such fools as to be unaware that unemployment did in fact exist; but they preferred to regard it as the outcome of 'friction' interfering with the smooth practical working of a theoretically perfect system. They did not recognize, though it is in fact the case, that situations often arise in which there is no conceivable level of wages or of interest on capital that will bring about a condition of full employment. This was

largely because, though they asserted again and again that costs were incomes, and incomes costs, they did not sufficiently realize that when the disemployment of any resource has resulted in cancelling the income previously accruing to it, the cancellation of that amount of purchasing power tends to bring with it a new 'equilibrium' at a lower level of output, so that there is no tendency to increase output until the cancelled income has been restored, and no restoration of the income until production has been increased. Say's Law, in effect, tells us nothing about the level at which employment will be maintained; and the classical assumption of full employment finds in it no kind of support.

What has been said in this chapter strongly suggests that those monetary reformers who allege the existence of a continual tendency to a deficiency of purchasing power are going wrong because they confuse a deficiency in what is available for spending with a deficiency in what is actually spent. It suggests that we must look more closely at the phenomenon of hoarding as a possible cause of unemployment and depression. This is, one may add, a much more hopeful line; for, if there really is a continued tendency towards a deficiency of purchasing power, it is not easy to understand why the capitalist economic system has not collapsed long ago.

Believers in the 'deficiency' theory will, no doubt, retort that it would have done so, had not the gap been filled by the creation of purchasing power by the banks. They will argue that bank credit, in addition to financing the large volume of intermediate transactions, is used to meet the deficiency in final purchasing power by being advanced for the buying of instruments of production and also, at certain times, for enabling Governments to pay out more than they receive as the yield of the taxes. It is, of course, perfectly true that bank credit can be, and is, used in this way—above all, by Governments in time of war. The effect of it being so used, however, is not as a rule to bring about a balance which would otherwise fail to exist, but rather to upset the balance and bring about an inflation of selling prices over costs. The most obvious example is to be found in what was called 'the gap', which arose during the war between Government payments and Government receipts from taxes and loans, was filled by bank borrowing, and was generally recognized as a force making for price-inflation. Bank credit, applied to the purchase of final goods, need not of course have this effect when it merely adjusts a temporary disequilibrium caused by hoarding; but if the banks make more advances for the purchase of new

finished goods than will balance sums withheld by the owners of disposable purchasing power in other forms, the effect must be to create an excess of purchasing power over costs, and thus to generate windfall profits somewhere.

Whether this is a bad thing or not, under capitalist conditions of production, we have in effect already inquired, when we were discussing proposals that the total volume of bank credits should be stabilized. It is not necessarily a bad thing, even if it causes windfall profits, if at the same time it causes additional productive resources to be put to use. There may be methods of bringing about full employment which will be better than that of extended bank credit applied to the purchase of finished goods; but, in the absence of such methods, the method of extending credit is much better than none at all. In any event, this issue is quite distinct from that of the alleged deficiency in the supply of purchasing power available apart from credit extended by the banks; and there is no substance in the view that bank credit is *continuously* employed to offset any such deficiency.

'Ah! no', say the exponents of the 'deficiency' theory. 'Bank credit is not so employed *continuously*. It is employed intermittently; and the moment it is withdrawn a slump occurs. Surely that proves our view to be correct?' No such thing. A contraction of bank credit can, of course, bring about a slump, by reducing the current supply of purchasing power; but it will have this effect just as much if there is no tendency towards a deficiency of final incomes to buy final products as if there were such a tendency. Any sudden contraction in the supply of means of payment will of course tend to bring about a slump. So much no one, I think, denies: but it is no evidence that there exists a standing deficiency, apart from the supply of bank credit, in the amount of purchasing power issuing from the productive system.

VI

SAVINGS, INVESTMENT, AND CONSUMPTION

REPUDIATION of the view that there exists, under the capitalist monetary system, a destructive tendency towards a deficiency of purchasing power by no means involves saying that all is well with the system. Is it not manifest that, even if there is no such tendency, there has existed at many times a deficiency of *demand*? Classical economists made a practice of identifying demand with purchasing power, because they made the assumption that all the purchasing power in men's hands would be actually spent, either on consumers' goods and services or by way of investment in capital goods, including additions to stocks of all sorts. They assumed that no one would merely bury his money receipts away, without spending them at all; or, to the extent to which they took account of hoarding by peasants, Indian rajahs, and other species of burying beetles, they assumed that the things hoarded would be stores of precious metals and the like, and that the hoarding of them would be in general analogous to the buying of any other valuable objects —pictures, for example—for keeping and not for re-sale. The precious objects so hoarded, being products of labour and business enterprise, would have yielded up incomes in the course of their production. The hoarders, in taking them off the market, simply cancelled the equivalent of these incomes against them, and no problems arose of any lack of balance between costs of production and the amount of available purchasing power. No doubt, the disappearance of the precious metal that could have been used as coined money in repeated acts of circulation would, in the absence of offsetting measures, have some effect in driving down prices below the point at which they would otherwise have stood. But this effect would be simply that of an enlarged non-monetary demand for the precious metals, exactly the same as if the demand for wedding-rings or gold plate had increased. It would not lead to any deficiency in the supply of purchasing power, except that a sudden *increase* in hoarding might cause some dislocation by forcing prices down or a sudden *decrease*, or *dishoarding*, by forcing them up. From a monetary standpoint, it would be simply as if so much less, or so much more, gold had been mined.

If, however, what is hoarded is not something of intrinsic value

equal to its monetary value, but token money in the form of paper or bank deposits, the effects are different. The hoarder then is not buying and keeping in his possession something that has cost effort to produce, and thereby withdrawing from the market a quantity of goods equivalent in value to his spending. He is in effect simply refusing to exercise his spending power, and therewith withdrawing money from the market without any equivalent withdrawal of goods. There are still as many goods and services as before to be sold; but there is less money being used to buy them. Consequently, on the average, the goods and services must be sold at lower prices, or alternatively some of them must remain unsold. It is in the nature of services that they cannot be stored; if they are not used currently, they cannot be used at all. Many goods can be stored without serious deterioration; but the cost of storing them is apt to be high, including as it does both the physical costs of housing and caring for the goods and the costs of insurance and of locking up the capital which is invested in them. The storage of goods in order to avoid sale at a falling price therefore involves in most cases a loss of value to the owner, who has to choose between selling them at once at a reduced price and holding them in the hope of a higher gross price later, *minus* deductions to cover the costs of storage.

A withdrawal of purchasing power from actual use in buying goods and services therefore involves losses somewhere—in the sense that it means a fall in the value of the current supply of goods and services to less than it would have been if the hoarding had not occurred. At least, it involves this unless any purchasing power thus withdrawn for hoarding is at once replaced by newly created purchasing power which is actually spent. If, as fast as persons in possession of spending power withdrew it for hoarding, the banks, or any other authorities endowed with the right to create 'money', were to replace it with substitute purchasing power of equivalent amount, and could ensure that the newly created purchasing power would in fact be expended on currently produced goods and services, no deficiency of demand would arise. There would, indeed, be a potential *excess* of demand; for the hoarders of purchasing power would be in a position to bring it back at any time into the market. It would therefore be necessary for the creators of the substitute purchasing power to stand ready at any moment to withdraw such of it as might no longer be needed to replace sums held back by the hoarders; and if the operations of creating and withdrawing the substitute means of payment could be perfectly syn-

chronized with the acts of hoarding and dishoarding, the effects of the hoarding would be entirely neutralized.

To a substantial extent this is what does actually happen. At any time a considerable amount of the available total of purchasing power is being held idle in one or another way. I do not go to my bank every time I want some money to spend: I keep a small amount by me in coins and notes, and only visit my bank for more when my supply runs low. I do not immediately invest in interest- or profit-yielding securities all the money I pay into my bank: I leave some of it on current account to meet my regular outgoings, and perhaps some on time-deposit while I am looking about for a suitable investment. The working-class household that does not use a bank does not pay out immediately all it receives in wages: it keeps some by for rent, and very likely some for other payments which are not made regularly week by week. The working classes on the whole turn their money over more rapidly than other classes; but in the aggregate a large amount of purchasing power is at any moment lying unused in their possession. All such holding of money is, in a wide sense, 'hoarding': it keeps money idle, instead of circulating from hand to hand, whether the holding of 'cash' takes the form of keeping a stock of coins and notes or of allowing money to remain on current or time-deposit in a bank.

The holding of 'cash' in these ways is the extreme form of what Lord Keynes called 'liquidity-preference'. Assets are 'liquid' in proportion as they are quickly and easily available as generalized purchasing power. Coins, notes, and bank deposits all possess this 'liquidity' in an absolute sense, (time-deposits, in practice, hardly less than deposits on current account). Other assets possess it in proportion as they are quickly convertible into 'cash' without thereby losing value. 'Hoarding' is in effect a preference for holding 'cash', or 'near-cash', over holding less liquid assets.

There is, no doubt, a distinction between holding money ready for use in the near future and holding money out of use, without any intention of spending it in the near future. But the difference is psychological rather than economic. To the extent to which the purchasing power is held out of use for the time being, the effect is the same, whatever the reason or the motive may be.

Now, the banks and the Mints which manufacture coined money naturally take the 'liquidity-preferences' of the public into account in deciding how much money to supply. Or, if they do not do this consciously, the level of prices will adjust itself to any steady habit

in this respect that exists in any particular society. To put the matter very crudely, if the supply of money were x, and the public regularly held y idle at any moment, the level of prices would adjust itself to an actual circulation of $x - y$. In fact, however, the public's liquidity-preference has in it both relatively stable and unstable elements. Most people have cash-holding habits, up to a point, and these give an element of stability to the demand for cash to be held idle. But clearly people will not hold just the same amounts in 'cash' when they are prosperous as when they are hard-up; and the demand for cash to be held liquid will be considerably greater in some quarters when there is little unemployment and business men are doing well. Under such conditions, the amount of 'cash' held as *pocket-money* will tend to rise sharply.

But as against this, the holdings of liquid cash by business firms may move just the other way. In times of economic activity, most firms will want all the resources they can lay hands on in order to finance their current operations. They will, therefore, be much more inclined to borrow heavily from the banks than to leave funds idle on deposit; whereas in times of depression, when firms are scaling down their activities, they may have on their hands considerable sums which they neither need for their own operations nor feel disposed to invest for the time being elsewhere. Consequently, in bad times, business funds will often tend to pile up in time-deposits in the banks, whereas current accounts will tend to fall because of a decrease in firms' readiness to take up bank advances. The total volume of deposits may or may not fall; but there is pretty certain to be a shift between current and time-deposits. In a serious depression, the total volume of deposits will fall; but it will fall by less than the decrease in bank advances, because of the tendency for time-deposits to rise.

The demand of the public for liquid funds is thus, in the aggregate, an unstable demand. The more stable elements in it, and also the regularly recurring elements of quite short-term instability, such as the Christmas and summer holiday demands for excess cash, can be fairly easily offset by bank action, where they do not become incorporated into the general structure of prices. But the more seriously unstable elements, which depend on the general level of current prosperity and employment, cannot be so easily offset. If serious hoarding occurs as a result of the holding back of funds by business men, the banks cannot easily counteract such hoarding by a creation of substitute money. Why they cannot do this at all

easily we have seen in an earlier chapter. They can make advances, and thus create money, only to the extent to which they can find borrowers whom they regard as credit-worthy. In times of depression, such borrowers are apt to be scarce, and accordingly it takes very large measures of Central Bank policy to push additional money into active circulation, and if the depression is severe, the task may be in practice beyond the Central Bank's power.

The form in which this serious kind of hoarding chiefly manifests itself is a refusal to *invest*. Under satisfactory economic conditions, the total sum accruing to the community and its members in the form of spending power is divided by its possessors into two streams, of which one goes to meet current costs of consumption and the other current costs of investment. People—private people—spend part of their incomes on goods and services which they consume either in a single act of consumption—e.g. food or theatre tickets—or in a series of acts of consumption spread over a period of time—e.g. a piano or a motor-car. Some, but not all, of them, after meeting these expenses of current living, have some income left over, which they *save*. This saved income they can either hoard (presumably with the intention, unless they are cash-hoarding misers, of expending it on something later on) or invest, either in new instruments of production or by buying a share in existing instruments or some security that will give them a title to future income. If they expend their savings on *new* instruments of production, they directly take off the market some of the goods currently produced, and thus offset the cost of producing them. If they buy existing assets, they *transfer* their purchasing power to someone else, who then has it to spend. He in turn spends it either on new or on existing assets, transferring to a third party what he spends in the latter way. Purchase of assets not currently produced never cancels the purchasing power so spent, but only transfers it to someone else. In a healthily functioning capitalist economy, all the sums thus transferred will in the end get spent either on new capital goods or on new consumers' goods or services, and thus the entire cost of producing the current output will be offset by purchases.

In this balance we must, of course, include the spending of the sums which accrue to the State and the local public authorities, and to other institutions of a public or quasi-public character. These sums arise chiefly by way of taxation, direct or indirect. Broadly speaking, direct taxes are direct transfers of spending power out of private incomes to the public authorities, whereas indirect taxes are

similar transfers brought about indirectly by means of additions to the prices of the goods and services offered for sale. Both represent sums which must be spent on the current product of industry if costs are to be fully recovered. Now, the public authorities spend their receipts, broadly speaking, in four ways: as payments for services rendered by public employees of all sorts; as social service payments to old age pensioners, unemployed, sick or disabled persons, and so on; as interest and sinking fund payments on public debts; and as payments for goods supplied, including both consumers' goods (e.g. for the armed forces, hospitals, and other institutions) and capital goods (e.g. armaments, roads, bridges, power-stations, town halls and other public capital works).

These public spendings will go out, equally with private spendings, either in buying the current product of industry, or enabling others to buy it, or in payments for existing assets (e.g. debt reduction, which is the public authority buying up its own capital liabilities). If they go in buying current products, the effect is precisely the same as when such products are bought by private persons. If they go in buying up existing assets, the effect is the same as when private persons buy such assets—a transference of the purchasing power involved. The income of public bodies goes into spending in just the same way as the income accruing to private persons. It involves no special problems relevant to the present argument.

All is well, then, as far as the balance of costs and purchasing power is concerned, as long as the whole of the income that is not used in meeting current consumption expenses is finally spent in buying *new* capital goods. All is not well if a part of the sum thus *not* used for consumption of currently produced goods and services is *not* spent on *new* capital goods, either because it is not spent at all, but hoarded, or because it goes on circulating in a series of speculative transactions in *old* capital goods, and does not get transferred to the financing of *new* investment.

The point about speculation we have discussed in an earlier chapter, and we can dismiss it briefly now. Speculation in existing assets only transfers, and does not cancel, purchasing power. It may, however, if the money passes from one speculator to another, hold an appreciable part of the supply of money locked up in a series of transactions which do not take any currently produced goods and services off the market; and in that case its effect will be to withdraw a part of current incomes from spending on the current product of industry, and will be the same in its reactions on the balance of

current supply and demand as if the money were hoarded and not spent at all.

This, however, is a secondary point. The main point is that spending on *new* capital assets is very much less stable than spending on consumption. Economists up to the time of Lord Keynes often spoke as if the act of *saving* (i.e. not spending on consumption) were the same as the act of *investing* in new capital goods. In other words, they assumed that all the money people *saved* out of their incomes would automatically get itself *invested* in newly produced capital assets. This, however, is clearly not the case. In an advanced economy such as ours, most investment is not made by the saver buying instruments of production for his own use—as the farmer may buy a tractor, or a reaper-binder, or a new milking-plant, out of saved income. Such investment does, of course, occur; but much more often the saver invests his money by lending it out to somebody else, who is prepared to pay interest for its use, or by buying a share in some company in the expectation of receiving a dividend, or by taking out an insurance policy, so that the task of investing the money is transferred to the insurance company.

Now, what can be done with the money thus saved evidently depends not on the will of the savers only, but on the nature and extent of the openings for new investment. The lender cannot lend, or take up *new* shares, unless he can find someone willing to borrow, or to float a company, or increase the capital of an existing company by offering new shares for sale. The willingness of business men to borrow, or to incur liabilities for share capital in companies, determines the available amount of new investment. Indeed, the matter is somewhat more complicated than this; for a number of offers of what are apparently new bonds or shares turn out, on examination, to be mere re-flotations, directed to the sale of existing capital assets and not to the creation of new ones. We can, however, for the moment ignore this complication, and stress only the essential point that savers, with money to invest, cannot, unless they are prepared directly to buy capital instruments for their own use, influence the quantity of new capital assets which business men are ready to create. Business men, in deciding whether to create new capital assets, will be governed by their expectations of the profit to be derived from them. When they regard the prospects of profit as good, they will be prepared to borrow, or to take up in share capital, large sums to be devoted to the purchase of new capital goods; but when they regard the prospects of profit as poor, they

will refuse to float new companies, or to extend old ones, and there will simply not be outlets for more than a greatly reduced investment of capital in new productive assets.

The older economists would have met this argument with the contention that the rate of interest would act as a balancing factor to bring the supply of, and the demand for, new capital for investment into equilibrium. But there is no real warrant for this view, which rests on the assumption that a low rate of interest will deter savers, so as to reduce the amount available for investment, whereas it will encourage borrowers, by widening the prospective margin of profit. This assumption is, in the main, invalid to-day. A low rate of interest will actually cause some people to save *more*, by increasing the sum which has to be saved in order to yield a given income in the future. If a man is saving in order to get an income of, say, £500 for his declining years, he will have to save more if the rate of interest is low than if it is high. In general, the rate of interest probably has but little effect on the volume of private saving.

Moreover, on the other side, will a fall in the rate of interest encourage borrowers? All other things being equal, no doubt it will; but all other things never are equal. The rate of interest constitutes, in most productive operations, so small a part of total cost that business men are guided very much more by their estimates of prospective market prices and demand than by any consideration of the rate of interest. Moreover, where capital is not borrowed at interest, but invested in shares,* the rate of interest does not enter into the picture. The determining factor in regulating the volume of investment in ordinary shares is the expectation of profit, quite apart from any question of interest rates. In practice, it is often a question, in any type of new investment, not between making, say, five per cent. or seven per cent. profit, but between making a satisfactory profit and incurring an absolute loss.

Of course, those who are considering the desirability of getting control of invested capital by borrowing or by share issues do not look exclusively to the prospects of profit in the immediate future. They pay some attention to the prospects of profit in the long run. But immediate conditions are apt to play a very large part in influencing their decisions in any period either of depression or of prosperity, except that they often begin taking longer views when they think a boom or a slump is nearing its end. They are, except at these times, unlikely to be much influenced by the rates of interest:

* Except, of course, preference shares carrying a limited dividend.

the volume of investment which they promote depends very much more on their estimates of prospective demand in the fairly near future.

Under these conditions, the processes of investment in the capitalist world are exceedingly unstable. There is a rush of projects for the investment of money in capital expansion when conditions are improving, and a widespread refusal to embark on new investment when times are bad. What, we must ask, happens when the recipients of incomes save out of their incomes more than they can either use themselves in the direct purchase of instruments of production or find business men ready to borrow from them, or receive from them as share capital, for a similar purpose?

It is plain that the 'saved' money, if it is not spent on new capital goods either directly by the savers or indirectly, cannot from the standpoint of the community as a whole be really saved at all; for the savings of the community consist of the capital goods which have been purchased by the money savings of its citizens or of itself acting in a corporate way. From the community standpoint, money 'saved' but not 'invested' in new capital assets is wasted. The community cannot, like an individual, make savings by hoarding paper money or balances in the bank. The individual who leaves his money in the bank can later on draw it out and spend it. From his standpoint, a real saving has been made, though for as long as he leaves his money idle he can get no income from it. From the standpoint of the community, the position is much worse. The individual's bank balance is simply a debt of the bank to its depositor: it represents no real wealth. The community would be no poorer, though the individual owner would be, if it simply disappeared.

This, however, is not all. If the individual by leaving his money idle and not spending it on anything can still keep its value for future spending, this must be done at somebody's expense. The effect of the non-use of the money for buying currently produced goods and services is, as we have seen, that the whole of the current product, if it is all to be sold, must exchange for less money. Unless, then, an equivalent quantity is held off the market and kept as stocks, prices must fall, and losses equivalent to the amount of money withheld from spending must be distributed somehow over the entire body of suppliers. The appearance of such losses, which will, of course, in practice be very unevenly spread, will drive some producers out of the market and will cause many more to curtail their output. If, on the other hand, goods are withdrawn into stocks,

the effect will be that the flow of orders for further goods to producers from traders who hold these stocks will be diminished. In either case, unemployment will appear, productive resources will be less fully utilized, and the income of the community will fall off. The supposed 'savings' will be cancelled—and perhaps much more than cancelled—by these losses and by the ensuing fall in production and employment. The 'savers' will still have their money in the banks; but it will be in effect money filched from other people. The community as a whole will be the poorer for the unused purchasing power.

Keynes has somewhat confused many students of his writings by the terminology which he has used in describing these processes. When he first drew attention to the fact that private 'saving' and investment are two quite different things, he said that there was no assurance, under the existing system, that Savings would equal Investment. Later on, he said that Savings must always be equal to Investment. The two statements do not really contradict each other; but the same terms are used in them in different senses. What Keynes meant when he said that Savings might not equal Investment was that there was no assurance that the sums which people *tried* to save, and from their personal standpoints did save, out of their incomes would be balanced by the sums which business men would be willing to borrow, or to receive as share capital, for use in buying currently produced capital goods. What he meant when he said that Savings must always equal Investment was that, from the standpoint of the community, private 'savings' which did not fructify, directly or indirectly, in new capital investment could not be regarded as real savings, but would be cancelled by losses incurred elsewhere. It is unfortunate that Keynes did not stick to a consistent terminology; but his argument is none the less valid for being put in a confusing way.

Keynes' analysis of the effects of the instability of investment which characterizes capitalist societies has been used to lead up to the conclusion that the State and other public bodies ought to take action to keep the total volume of investment in *new* capital goods reasonably steady. This, it is often suggested, could be done if such bodies would vary their own investment inversely with the investment made by private firms, setting on foot more projects of 'public works' in bad times and fewer in good times, so as to keep the total demand for capital goods in balance with the desire of the members of the community to save. The State and other public

bodies would borrow the money needed for the execution of these capital works, and would thus take from the 'savers' the balance of their savings which private business men were not willing to take off their hands. This would not mean that the volume of 'public works' would have to be kept constant, irrespective of the need for them. It would have to vary, to the extent to which it was financed by borrowing, in accordance both with the amounts which the recipients of income chose to save and with the amounts which business men chose to take up in new investments. Of course, the State and other public bodies could, in addition to fulfilling this 'balancing' function, maintain a regular basic programme of investment on any scale they thought fit. The more industries are run by the State or by public bodies acting under its authority, the larger will be the public sector in the ordinary investment market. Where the public bodies act in this way, the total demand for investable money will be the sum of private and public borrowing; and the public bodies will have to stand ready with a programme of *additional* investment projects which can be either advanced in time or deferred according to the activity of the private investment market.

It is, however, possible for the State, instead of undertaking additional investment of its own, to take steps that will increase the amount of *private* investment up to the required total by stimulating the demand for the products it will provide. This can be done by leaving more money in the hands of the income receivers—i.e. by reducing taxation on incomes, or by remitting taxes which fall on businesses—especially on profit reserves actually invested in new capital goods—or by subsidizing particular kinds of investment—e.g. in house-building—or in a variety of other ways. The effect of the additional investment on employment is not altered when it is made under private instead of public auspices, though of course the kinds of investment that are stimulated will differ according to the methods used. If the State leaves more purchasing power in the hands of the main body of consumers, the main effect will be to stimulate investment in the industries supplying consumers' goods and services. If it remits taxation on profits which are used for buying capital goods, the effects will be much less certain; for, as there will be little direct stimulus to consumers' demand, the main encouragement will be to the improvement of the means of production by building new factories or installing more up-to-date plant, and this may result rather in an accelerated scrapping of

existing capital goods than in an addition to total productive capacity. There will, however, be an addition to the demand for new capital goods; and if the capital goods industries are in a state of depression, a revival in this sector of the economy will indirectly create consumers' demand through the increased wages and other incomes paid out by these industries. Subsidies to particular industries, such as house-building, will of course have similar indirect effects.

It must therefore be agreed that the Keynesian argument does not necessarily lead to the conclusion that the State should correct a deficiency in total investment by increasing its own investment. It remains true, however, that where the State does act in this way it can be much more certain of the results than where it sets out to stimulate private investment, both because the private investors may be reluctant to respond or the income-receivers to spend the additional sums left in their hands, and because it can apply its own investment more easily at the points of most serious depression, and without expending a large part of what it pays out in subsidies to those who neither need them nor put them to any effective use in increasing total production.

At the risk of appearing tedious, I must say again that the 'investment' of which I am speaking in this chapter is throughout *real* investment in newly produced capital goods, and does not include the mere purchase from a previous owner of existing capital assets. From the standpoint of the private saver, it is irrelevant whether the assets he acquires are new or old; but from the standpoint of the community the only investment is that which brings new capital assets into being. The other is a mere *transfer* of ownership, not a process of creative investment.

The view that the State and other public bodies should intervene to keep the total volume of investment at the right level is, of course, closely bound up with the view that it is the State's responsibility to maintain full employment. The State's function in this respect can be most easily fulfilled where there is a large sector of capital development directly under public control. If the State and the local authorities regularly undertake the building, not only of roads and bridges, schools and hospitals, armaments and postal equipment, but also of houses, waterworks, electricity stations and transmission lines, ports and harbours, and other essential public utility services, their power to accelerate or decelerate investment is obviously much larger and easier to exercise than if their normal capital operations

are confined within a narrower field. If the main forms of transport, and perhaps some of the great basic industries, are added to the 'public sector' of the economy, plainly the State's task will be easier still; for the wider the range of capital-using services under public control, the easier will it be to select projects which can be advanced in time or postponed so as to serve the required 'balancing' purpose.

Where public bodies thus enter the field with additional capital projects, the effect is not confined to the employment directly caused by them. Indeed a whole chain of effects is set in motion. The public works directly employ certain labour and other factors of production; materials and other requisites for them have to be ordered from private firms, which take on more labour and in their turn order more materials and perhaps new machines; and so on in an endless series of stimuli to various parts of the economic system. At the same time, all the previously unemployed workers who are taken on at all these stages have their incomes increased, and become able to buy more consumers' goods and services. All these indirect effects of a policy of public investment are known by economists as 'multiplier effects'. If all the indirect effects add up to an additional volume of employment equal to that directly provided by the public investment, the 'multiplier' is 2; if to twice as much, 3; and so on. Of course it is no magical property of public investment to produce these effects. *Any* investment produces them. The point is that they *are* produced when public bodies step in with additional investment designed to offset a shortage in private willingness to borrow for capital works, or to risk money in such works.

It must not, however, be supposed that the State is necessarily confined to promoting investment in industries and services which are publicly owned and operated. Exactly the same effects will be produced if the State, instead of undertaking investment itself, or through public bodies such as local authorities, can stimulate an increase of private investment. There are various possible ways of doing this. One is to give guarantees of interest, and if necessary of principal as well, to persons who invest in certain approved types of private enterprise. This was done, on a small scale, under the Trade Facilities Act after the first World War. The State can also proceed by way of subsidies to private enterprise. It did this, for example, in the Housing Act of 1923, which sought to stimulate investment in house-building by offering a subsidy to anyone who built a house, and not only to municipalities.

Subsidies, however, are notoriously difficult to operate without

waste; for it is difficult to give them to those who need this stimulus to promote investment without giving them equally to persons who do not need them, and would be ready to act even if no subsidy were given. This objection applies much less to guarantees than to subsidies. But there are other objections. If returns are assured irrespective of efficiency, what incentives will there be to put the sums invested to effective use? If a higher level of investment is achieved only by promoting costly and slackly administered enterprises, full employment of a sort may be maintained, but the standard of living will be low and the taint of inefficiency will be likely to spread. State-guaranteed private enterprise combines the disadvantages of both systems. Therefore, though in theory there would be nothing to prevent the State from fulfilling the required function of steadying the rate of investment even if it had no industries or services under its own control, any such 'balancing' policy would be very difficult to work in practice under these conditions. This, however, is not to suggest that there is any need, in order to apply the policy of maintaining total investment, to extend public ownership over more than a small part of the whole field of industry.*

The Keynesian school of economists, taking their stand on the view that the instability of investment was the main cause of the disastrous economic fluctuations which beset capitalist societies in the inter-war period, and that this instability lay at the root of the instability of credit, put the main stress in their proposals for reform on the assumption by the State of the responsibility for holding total investment at a level just high enough to sustain full employment. Monetary policy in the narrower sense, they said, plays a secondary role, and should be so adjusted as to fit in with the requirements of a right investment policy.

Plainly, the Keynesians believed that there existed, in the capitalist societies of the 1930s, a strong tendency for the actual level of investment to fall below what was needed for full employment. They offered a remedy for this defect; but why, in their opinion, did the defect exist? Why should it have been necessary for the State to step in to ensure a level of investment high enough to clear the market of the savings which the recipients of incomes were attempting to make?

* In my book, *The Means to Full Employment* (Gollancz, 1943), I have discussed this particular issue at length. I have no space to do more than refer to it cursorily here.

The answer to this question has usually been given, primarily, in terms of what Keynes called the 'propensity to consume' and the 'propensity to save'. In general, it has been argued, those with the lower incomes have the greater 'propensity to consume' and accordingly the smaller 'propensity to save'; and at the higher income levels the propensities are reversed. Thus, a society in which the general level of wealth is increasing at all points will tend to save a higher proportion of its total income; and so will a society in which income is being re-distributed to the advantage of the wealthier classes. This generalization has in practice a good many exceptions. The wealthiest classes are not necessarily the most 'saving': in Great Britain up to 1939 probably the middle classes on the whole saved the highest proportion of their incomes. Moreover, in present-day capitalist societies, the greater part of 'saving' and investment in new capital goods is done, not by individuals out of their incomes, but by business firms which place part of their profits in reserve accounts, instead of distributing the whole as dividends to shareholders. It does, however, hold good, broadly, that the poorer classes cannot afford to save much without enduring privations which they will not as a rule accept, and that accordingly the main bulk of savings is made either by persons who are well above the 'poverty line' or by business firms owned by such persons. The only other large source is through insurance, including pension schemes.

It was argued in the 1930s that the increased number of persons in modern communities who possessed a surplus over the necessities of life had led to a growing 'propensity to save', but that this increase had not been fully or continuously balanced by the growth of the willingness of business men to undertake investment. Why should this have been so? One relevant factor is that the only use of most capital goods is to facilitate the making of consumers' goods: so that the demand for investment depends in the last resort on the prospective demand for consumers' goods—that is, on the maintenance of the 'propensity to consume'. The production of new capital goods beyond what are needed to produce the goods that will satisfy consumers' demands can result only in losses somewhere —either in a failure to use the new capital goods at a profit, or in the driving out of production of older capital goods which are not efficient enough to hold their place in competition with new instruments of production. Accordingly, if the 'propensity to save' is pressed too far, it will, by narrowing the market for consumers'

goods, stultify itself, unless the Government undertakes the responsibility for keeping the volume of real investment high enough to absorb the savings. Doubtless, it is very right and proper that obsolescent or worn-out instruments of production should be continually in process of being driven out of the market by new and more efficient instruments; but if the process is speeded up beyond a certain point, it spreads devastation and ruin, by causing machines to be scrapped wholesale long before they have been made to pay for themselves out of the value of the products created with their help. Doubtless, it is necessary that some of the new enterprises should fail; but if failure is widespread, the result will be that few will be willing to take the risks of productive investment.

A sufficient maintenance of the 'propensity to consume' in the community as a whole is therefore normally indispensable for the continuance of healthy economic conditions. I say 'normally' because, where a country is undergoing a process of rapid industrialization, especially if the Government is carrying through such a process as a matter of deliberate policy, the lower the 'propensity to consume' is, the faster can the industrialization proceed—up to a point. But even in such a case, unless the entire process is devoted to producing armaments or other 'public works' for which there is no private market (e.g. roads, or schools, or hospitals), in the long run the industrial developments will either lead to a higher production of consumers' goods, or be brought to a stand for lack of demand for their products. Except under these special and temporary conditions, the demand for savings is finally limited by the demand for consumers' goods; and where the 'propensity to save' is tending to rise unduly, action is needed to prevent depression and crisis. This action can take a variety of forms. The State can take steps, e.g. by minimum-wage legislation, to raise the incomes of the worse-paid classes; it can employ taxation as an instrument for the re-distribution of incomes, as it does in the case of social services financed out of the product of a tax system having a heavy incidence on the higher incomes—e.g. family allowances; it can lower total taxation so as to leave more net income at the taxpayers' disposal, and can meet the deficit thus caused by borrowing; it can directly subsidize consumption out of borrowed money, which is another form of 'deficit financing'; it can, alternatively, incur a deficit and meet it, not by borrowing, but by a direct creation of additional purchasing power, in the form of currency or of bank money; or, as we have seen, it can develop forms of 'public works' which lead

to a higher level of *collective* consumption—e.g. by the provision of free services, such as roads, parks, playing-fields, swimming-pools, municipal theatres, and so on (or of armaments). All these methods except the last will directly stimulate private consumption: the last will direct a part of the investment, under public auspices, into channels which swell the volume of collective consumption of durable consumers' goods.*

A fall in the 'propensity to consume' is, then, one possible explanation of a tendency for the 'propensity to save' to outrun the willingness of business men to accept money for investment. There is, however, a second explanation, not inconsistent with the first, but supplementary. Where monopoly exists, it may pay the monopolists best to keep down the volume of production in order to maintain prices at a high level and thus reap higher aggregate profits. This, where it is done, will both directly limit openings for investment and, by restricting employment and increasing profits, will accentuate the inequality of incomes and thus lead to a further self-defeating increase in the 'propensity to save'. Monopoly and the increase in the 'propensity to save' due to a rise in the higher incomes are thus not independent factors, but may work together to produce the same effects.†

This falling 'propensity to consume' is, of course, only a newfangled name for a very old idea—that of 'under-consumption'. It has been argued by many generations of heterodox economists

* The distinction between capital goods and consumers' goods, which I have used throughout this chapter, is at certain points unsatisfactory, and for some purposes it is preferable to divide goods into three categories—production goods, immediate consumption goods, and durable consumers' goods. A house is a capital good from the standpoint of the landlord, but a consumers' good from that of the tenant, who is gradually using up its capital value by wearing it out. It is, in effect, a durable consumers' good which functions also as a capital good. Some such goods, such as a house, can be and are habitually let out for money: others, such as roads, no longer are (except where turnpikes survive), but are consumed collectively and paid for out of the public purse. So are armaments.

† I am not suggesting that monopoly *always* works in this way. It does so most of all when a general condition of depression exists; but even in such a situation it need not do so in an industry which is expanding rapidly because of technical change—for such an industry may find its market highly elastic even in a depression. There are, indeed, cases in which a monopolistic concern in control of the market may be readier to expand production than an industry in which a large number of struggling firms, unable to raise fresh capital in order to improve their efficiency, resort in desperation to a restrictive cartel. In general, the change made in the text applies much more to cartels than to monopolistic single concerns.

that at the root of economic crises lies the maldistribution of incomes between rich and poor, resulting in a restricted demand for consumers' goods side by side with a growing capacity to produce. The older exponents of this view used, however, commonly to speak as if the correlative of 'under-consumption' were over-investment, leading to a glut of consumers' goods of which the makers found it impossible to dispose. They had not fully appreciated that the maldistribution of incomes in the community may in fact damp down investment as well as consumption, by making business men unwilling to create additional capital instruments and by strengthening monopolistic tendencies among the owners of the existing instruments. Where this happens, crisis will ensue just as much as it would from over-investment in capital goods; for the failure to purchase capital goods will throw the producers of such goods out of work, and the consequent loss of purchasing power among those who would have found employment in making such goods will depress the demand for consumers' goods. Crisis can result from either over-investment or under-investment: the more monopoly holds the field, the likelier it is that under-investment will be what actually occurs. For it is one of the main purposes of monopolists to prevent the unregulated entry of new capital into the fields which they control, and to keep the total investment at a level which will exclude what the monopolists regard as 'redundant capacity' and thus make it easy to restrict the level of output to what will ensure the largest aggregate of profit.

So far in this chapter I have been discussing what occurs when the 'propensity to save' is too high—or, what is the same thing, the 'propensity to consume' too low—for all the attempted savings to be taken up and invested in capital assets unless the State itself either takes them up and invests them in 'public works' or adopts some other method of stimulating employment through tax remissions or subsidies. This was the situation that faced most of the capitalist countries in the 'thirties, when Keynes worked out his ideas. But since 1945 most of these countries have been in a quite different situation. In Great Britain, for example, the rates of taxation on the bigger incomes are now so high that little saving is done by individuals of the wealthy classes (though a large section of the middle class still saves considerably by means of insurance policies). Part of the proceeds of this higher taxation is re-distributed through the social services, both in cash benefits and in services in kind. Another part goes to meet the interest on public debts, which have

risen to a very high level. Another large part goes on armaments, and on research connected with them; for arming has become more than ever a terribly costly business. In face of these high taxes, the greater part of private saving is now, more than ever, derived from the undistributed profits of business concerns.

Persistent over-saving, then, is for the present unlikely to arise; for business concerns will hardly accumulate as reserves more than they can expect to be in a position to invest. They may indeed, in face of an actual or expected trade recession or of a shortage in supplies of the capital goods they want, hoard their reserves for a time instead of spending them at once; and such hoarding, if it occurred, would intensify depression. But in fact, since 1945, the situation of the British economy has been one in which demand for both investment and consumers' goods has been for the most part in excess of supply. The state of affairs has been one of full employment, or near it, though there have been ups and downs in particular industries—e.g. cotton textiles. Accordingly, the appropriate policies have been different from those which were best in the 1930s, when action was needed to increase employment.

During the 1930s economists were concerned with the problems of reducing unemployment and stimulating higher production; and the entire Keynesian approach arose out of an actual situation in which resources were being very seriously under-used. To some extent, this situation exists to-day in certain countries—notably Italy, with its rapidly increasing population and its shortage of other productive resources. But in most capitalist countries between 1945 and 1954 the problem has been, not under-employment, but rather a shortage of productive resources for meeting current demands, so that many firms have had their order-books filled for a long time ahead and many prospective buyers have had to wait for a long time before they could get their requirements met. This time-lag in fulfilling orders has not of course applied to all kinds of goods: it has arisen mainly either out of shortages of particular materials or out of a concentration of too many competitive demands upon a particular kind of product. For example, shortage of some sorts of steel has checked the rise of output in certain branches of engineering; and timber shortage has had similar effects on building. Again, the demand for armaments has conflicted with the demand for machinery for use in industry; and the demand for milk has been in competition with the demand for meat. Such examples could be multiplied: the most glaring of all is the conflict of demands on the

building industry for houses, factories, schools, hospitals, and a host of other kinds of constructional work.

Apart from such conflicts of demand and from delays arising out of scarcities of materials, there is the wider question whether there has been since 1945 an excess of total demand in sharp contrast to the deficiency of the inter-war period. Have purchasers as a whole been trying to buy more than the available productive resources can supply? Has there been, not a deficiency, but an excess of purchasing power? Such an excess is called by economists 'demand-inflation'; and many of them have suggested that this has existed in the post-war world and has led to a condition, not of full employment, but of 'over-employment'.

This is not so simple a matter as it may sound. Undoubtedly, there was at the end of the war a sudden release of demands which it had been impossible to satisfy during hostilities. There were demands for the restoration of devastated areas; demands from industries that had been kept down during the war for new equipment to make up arrears; demands from private consumers whose clothing and furnishings had worn out, or who were eager to get back to things of which wartime austerity had deprived them. These arrears of demand created for the time a sellers' market. Much of the money that lay behind the demand had piled up during the war in unspendable savings of individuals and, much more, of business concerns; and a further source was bank borrowing—for banks were ready, and were encouraged, to lend money for the restoration of productive efficiency.

During the period immediately after the war the British Government, in control of the Bank of England, deliberately used its influence to keep interest rates down and credit plentiful in order to stimulate economic recovery. The high incomes resulting from this policy would have led to a seriously inflationary state of affairs unless a large fraction of the money distributed in incomes had been withdrawn from the recipients by taxation, not only of the rich, but of all classes, at high levels. In order to prevent uncontrollable inflation it was necessary for the Government to raise in taxes considerably more than it spent on wages, salaries, cash benefits, and goods and services for public use, with the deliberate purpose of limiting the purchasing power in the hands of private persons. The Chancellor of the Exchequer needed to budget for a revenue surplus, as was actually done in 1948. Later, in view of the existence of full employment, the Labour Government modified its policy

by allowing a moderate rise in interest rates in order to discourage excessive borrowing; but it continued to follow a policy of liberal credit, and to mop up surplus purchasing power by high taxation. After the crisis of 1951 the Conservative Government allowed interest rates to be further increased, thus adding considerably to the cost of servicing the National Debt, and at the same time ceased to budget for a surplus, trusting instead to the restriction of bank credit and to the removal of food subsidies to limit total demand.

Moreover, in order to keep the total of money incomes in check, the Trade Unions were urged by the Government throughout the post-war period to adopt a policy of 'wage-restraint'—that is, not to take full advantage of the bargaining power put into their hands by the high level of employment. The Trade Unions, up to 1950, agreed to this, as they realized that undue pressure for higher money wages would be bound to lead to higher prices in face of the shortage of goods available for purchase by consumers, and would thus be self-defeating. They insisted, however, as a condition that businesses should be called upon to limit their dividends to shareholders, and that profits in general should be highly taxed. Special profits taxes were imposed; and most big business firms (though not all) agreed to a policy of dividend limitation—which of course meant the placing of a higher proportion of total profits to reserve. This double policy, however, gradually broke down after 1950; and before long the Government resorted to a more stringent credit policy in order to check inflationary tendencies, and also began to restrict consumers' purchasing power by removing a large part of the subsidies on food which had been used to keep down the cost of living during the period of restraint.

The situation which existed in Great Britain after 1945—and had its parallels in a number of other countries—has been described as one of 'controlled inflation'. The controls took a number of different forms—rationing of scarce materials and of certain consumers' goods; the requirement of licences for carrying out certain types of work, e.g. building; suggestions to bankers to go slow with credits for particular types of work; slowing down of wage-advances by means of 'wage-restraint'; attempts to check dividend distribution; special taxes on excess profits and on purchases of many kinds of goods; high general taxation designed to take money out of the consumer's pockets; and so on. These policies were to a considerable extent effective; but in face of them there remained a persistent excess of purchasing power.

Some economists attributed this inflationary tendency mainly to the high level of wage-earnings, despite the considerable success of 'wage-restraint' in keeping them well below the level they would have reached if the Trade Unions had made full use of their power. But in fact the largest part of the pressure came from high profits, and took the form of a demand for capital equipment which was in sharp conflict both with the need to expand exports and, after 1947, with the Government's demands for re-armament. Most big and many small firms had large profit-reserves built up during and since the war which they were eager to spend if they could get the capital goods they wanted, but would hold for the time being if they could not; and these reserves constituted a large mass of spending power ready to be released as the goods could be got, and in the meantime looming over the market. Moreover, profits were bound to stay high and thus constantly to replenish this source of purchasing power, as long as there continued to be an abnormally wide spread in efficiency between high-cost and low-cost firms, and as long as it remained impracticable to eliminate the high-cost producers by supplying enough new capital equipment to drive them out of the market.

Whether, over and above this, wages were too high, despite wage-restraint, is another question. Those who argued that they were used principally the argument that their effect was to swell the demand for imported consumers' goods beyond what the economy could afford to pay for with exports; and in support of this view they pointed to the heavy deficiency in the British balance of payments after 1945 and to the use of the American Loan of 1946 to sustain British consumption. This contention, however, in view of the general effectiveness of 'wage restraint', had little meaning unless what was meant was that British standards of living needed to be sharply reduced on account of Great Britain's changed position in relation to the rest of the world.

What was true after 1945, in Great Britain and in many other countries, was that there arose a simultaneous pressure from a number of sources on a limited total productive capacity, and that this pressure had to be held in check if serious inflation was to be prevented. It arose because Great Britain and the other countries similarly affected were attempting at one and the same time to do at least five things which were bound to conflict at many points. These things were, (*a*) the maintenance of a high level of military expenditure, both on forces overseas and on arms production and

use of man-power in the armed forces; (*b*) the increase of exports, especially of goods for which there was a high demand at home; (*c*) the re-equipment of industries and services which had war arrears to be made up; (*d*) the development of greatly improved public services in the fields of health and education and of better social services involving cash payments; and (*e*) a big housing programme. In face of these conflicting pressures, total demand in many fields was bound to outrun supply; and the calls on banks to supply credit were bound to result in an emission of money that could be prevented from seriously inflating prices only by government counter-measures of the types already described.

At this stage I do not wish to embark on any full discussion of the monetary aspects of these events. I have to mention them here, because they illustrate the problems which arise when a Government, instead of needing to inject additional purchasing power into the market, is faced with an actual or theoretical excess of purchasing power at current prices, and therefore with an actually or potentially inflationary situation. In Great Britain after 1945 the position was complicated by the existence of a serious deficit in the balance of payments. This will have to be discussed in a later chapter; and it will then be possible to consider the problem as a whole more closely than it can be considered without bringing in aspects of monetary policy which it would be premature to introduce just yet.

In this chapter, we have seen that Great Britain—and indeed most capitalist countries—have been faced during the past quarter of a century with two entirely different economic situations. Up to 1939 the problem was to find means of preventing unemployment, both of men and women and of other productive resources. To this problem Keynes appeared to an increasing number both of economists and of politicians to have provided the essentials of an answer. But since 1945 the boot has been on the other foot: the problem has been, not to ensure full employment for the time being, but rather to keep in check a persistent tendency for demand to outrun supply. Economists in the 1930s were apt to ignore the latter type of situation, and to concentrate on the means of promoting full employment. No doubt, to some extent the existence of full employment to-day over a large part of the capitalist world is due to the successful application of the techniques which Keynes recommended; but in the main it arises out of quite other causes—the urgent need to restore and re-fashion economies, the outpouring of

American aid, and the pressure of re-armament. To state these causes is to make evident that there is no assurance that they will continue in operation. The capitalist world may at any time find itself back in a situation in which it will again be preoccupied with the problem of maintaining employment. Only when such a situation arises, or is seriously threatened, will it be possible to know how efficiently the Keynesian techniques will work in the post-war world. They were thought out mainly in terms of *national* action to maintain the level of investment; and they seem likely to remain appropriate as instruments for coping with a threatened American slump—if the Americans, in such a situation, see fit to employ them to the full. But how far will they serve Great Britain, or any other country which finds itself faced with a slump arising, not out of internal disequilibrium, but out of an American crisis coupled, in all probability, with a precipitate withdrawal of American aid? In the world of to-day, prosperity in the United States is an indispensable prop of the entire capitalist economy. A serious American recession would spell disaster not only for every country which depends on American aid, but also for every country which depends largely on exports for its means of living. It would plunge the primary producers into crisis and destroy their power to buy the exports of the manufacturing countries; it would upset the balance of payments and set one country after another scrambling to cut imports; and it would engender alarming political as well as economic disorders in many parts of the world. Because this is known, the disaster is less likely to be allowed to happen than it would be if the consequences were unforeseen; but that does not mean that there is no danger of it happening. As we shall see later, the Americans have resolutely refused to bind themselves to follow any concerted *international* policy for the maintenance of full employment. The attempt to write such measures into the draft Charter of the International Trade Organization was one of the reasons for its rejection by the United States; and the Report of the United Nations Group of Experts on *National and International Measures for Full Employment*, issued in 1949, which attempted to work out a detailed international plan, was still-born in face of American refusal to consider entering into the obligations it involved. Yet it is plain that the maintenance of full employment is to-day essentially an international as well as a national problem, and will remain so at any rate for as long as the rest of the capitalist world continues to be in disequilibrium with, and dependent upon, the United States.

The Keynesian techniques, applied within a single country, may still avail to *mitigate* a slump; but, except in the United States, they certainly cannot avail to prevent or fully to correct it by merely national means. To this problem we shall have to come back later: for the present we need only record that, though post-war monetary issues have turned mainly on the methods to be used for controlling inflationary tendencies, we may soon find ourselves back in a situation in which the problem will again be, not an excess of demand, but a collapse of the market and a sharp decline in the willingness to invest.

VII

METHODS OF RE-DISTRIBUTING INCOMES

As we saw in the preceding chapter, Keynes, in his *General Theory*, was concerned principally with the methods to be used for correcting a tendency towards under-investment, when the level of attempted 'saving' was too high in relation to the willingness of business men to take the risks of buying new instruments of production. The principal remedy suggested was the adoption of measures designed to increase investment enough to absorb all attempted 'savings', either by increasing public investment or by offering incentives to encourage private investment. Much less consideration was given to the alternative of raising the total purchasing power of consumers and thus, by stimulating the demand for consumers' goods, making it more worth the while of business men to invest in the means of producing them. Some consideration was given to this alternative; but it tended to be thrust into the background. It was evidently a matter, not only of increasing total purchasing power, but more particularly of increasing the purchasing power of the income groups which had the greatest 'propensity to consume'. It therefore involved the question of re-distributing incomes, as well as that of adding to their total amount.

The first and most obvious way of bringing about a re-distribution of incomes is by legislation laying down minimum rates of wages below which no employment is allowed. Such legislation can be either general or particular, or both. It can lay down certain basic minima applicable to any trade or occupation, and differentiated, as may be thought best, according to age and sex; or it can prescribe specific minimum rates or scales of wages for persons employed in particular industries or occupations; or it can combine both systems, by laying down general minimum rates which are applicable where no specific rates are fixed. In Great Britain there is no general provision for a minimum wage. Wages in a number of industries, chiefly among those in which women's employment predominates, are regulated by statutory Councils under the Wages Councils Act; and there is special legislation prescribing minimum rates for workers in agriculture and in the catering trades. These Acts in principle prescribe only *minima*, and do not prevent any employer from paying, or any body of workers from demanding,

more; but in practice the minimum wages may tend to become the standard wages for the majority of the workers in the trades concerned. Some countries, notably Australia and New Zealand, have gone much further than Great Britain in prescribing minimum rates over industry as a whole, and in using wage legislation deliberately as an instrument for enforcing the recognition of a basic standard of living. In Great Britain, where, until the Wages Councils Act of 1944 was passed, only a very limited range of occupations was covered, the effect has been much more restricted. Wage regulation by law has been used to prevent abnormal underpayment in a certain number of particular trades; and even now no attempt has been made to employ it as an instrument for raising the general standards of living among the working classes. Its effects on the general distribution of incomes have been small.

The most obvious difficulty in the way of using wage legislation as a major means of re-distributing incomes is that it may affect the competitive position of the industries covered by it in the world market. It is obviously much easier to pursue in countries which are prepared to protect by import duties or other restrictions the home markets of trades which find themselves seriously affected by foreign competition at the higher wage-levels than in countries into which foreign goods can be imported with little or no restriction. The Australian legislation in particular had for its complement a high tariff on industrial imports which were competitive with home products. Such protection obviously cannot help export trades; and the difficulties of the exporting industries have been a main obstacle to the extension of minimum-wage legislation in Great Britain, as well as to the raising of wages in the trades which have been covered by it. No doubt, in some instances, the raising of wages by law can so increase the efficiency of the trades affected—both by improving the quality of the labour employed and by driving the firms to adopt more mechanized, or in other respects more efficient, methods of production—as to increase rather than diminish their competitive capacity. But this will hold good only over a limited field, and to a limited extent. Any minimum-wage policy designed to bring about a substantial re-distribution of the national income to the workers' advantage would undoubtedly raise costs of production, at any rate in the short run, and would therefore react on the competitive capacity of some export trades, even if protection were afforded in the home market. It would be possible to offset these effects by subsidies to exporters; but such a policy would be

very liable to provoke retaliation by other countries, in which the cry of 'export dumping' would be raised, and would in some cases be contrary to international agreements. Only a completely state-controlled economy, such as exists in the Soviet Union, can insulate itself from such effects. Where all foreign trade is a state monopoly, as it is in the Soviet Union, exports are determined, not by their profitability to the producers, but by considerations of public policy. It may pay the State to export goods in exchange for imports which would cost more to produce at home than the exports for which they are exchanged, even if the exports are sold under cost. This, and not the prospect of profit from the sale of the exports, settles export policy; but clearly, in countries working under the system of production for profit, exports are settled in a quite different way and the power of the State to raise wages without affecting the volume of sales and employment in the exporting industries is much more limited.

Even if we set aside the problem of exports, it is clear that any wage-policy which adds to the costs of production will tend, other things being equal, to limit sales; for the higher prices are, the less will be bought, if the incomes in the hands of the consumers remain unchanged. But will they remain unchanged? Will not a redistribution of incomes in favour of the wage-earners increase the 'propensity to consume', and thus widen the market for consumers' goods enough to balance any rise in costs? This may happen; but a good deal will depend on the ways in which the business world reacts to the increase in wage-costs. Under normal conditions, there is a powerful tendency for such increases to lead to price-rises in the consumers' market well beyond the actual rise in costs. A good many commodities pass through many hands on their way to the consumers; and at each stage there is a tendency to add what is regarded as a 'reasonable percentage margin' to the price at the previous stage. Thus, the effect of wage-increases in manufacture is apt to be passed on with cumulative effects through the subsequent stages; and this tendency is naturally most marked when there is any sort of ring or monopoly at any stage. The higher 'propensity to consume' resulting from bigger incomes at the bottom may thus be offset by an addition to profits at subsequent stages of production and distribution, with the consequence that less may be sold at the higher prices, and the effect may be to decrease employment.

The reactions on employment, especially in the export trades, are indeed, under capitalism, the main obstacle to pursuing high-wage

policies far enough to produce any substantial effect on the distribution of incomes. This is no case against pursuing such policies as far as they can safely be pursued; but it is a reason against expecting from them much effect on the general distribution of the national income.

The second obvious way of attempting to bring about a re-distribution of incomes is by taxation levied so as to fall mainly on the richer classes, and by the use of the proceeds of this taxation to add to the incomes of the poorer. One method of doing this is by providing free of charge, or at less than cost price, goods or services either exclusively to persons of low income or to all comers—for the poor so outnumber the rich that it costs comparatively little more to extend the benefit of communal services to everybody who chooses to take advantage of them. This is the method followed in those social services which provide, not cash benefits, but goods or services—cheap milk, school meals, medical attendance under the National Health Service, and so on. True, most of these services are not at present provided either free or to everybody. But they are at least subsidized so that the recipients pay less than the full cost; and it is an essential part of the National Health Service to provide free medical services—though no longer quite free medicines or appliances—for all comers. To the same group belong the wartime and post-war subsidies designed to keep down the cost of certain essential food supplies. These subsidies were given to all, the rich man paying no more for his subsidized loaf or joint of meat than the poor man. Similarly, under normal conditions, the schools and other educational institutions provided by the nation are open to all, either free, in the case of elementary and public secondary schools, or at a subsidized rate, as in most other forms of state-aided education. True, the rich often prefer to send their children to so-called 'public' or to private schools outside the state system. But that is their choice: they are free to use the public educational services if they wish.

A second way of re-distributing incomes through the social services is by paying out cash benefits to certain needy citizens—family allowances, old age pensions, unemployment, injury and sickness benefits, and what used to be called Poor Relief, but has been re-named National Assistance. Some of these payments are made subject to a 'Means Test'—e.g. Assistance Board payments: others have been on a contributory basis, the State merely making a contribution which has been added to those of the employed persons and of their employers to meet the cost. Clearly, the contributions

paid by the workers under these schemes have not represented for the most part a re-distribution of incomes between rich and poor, though they have as between different sections of the poorer classes. Those who are less liable to sickness or unemployment have helped to pay for those who are more liable; and the only contribution levied on the richer classes has been their share in the payments made by the State in aid of the finance of the various schemes. The employer's contribution cannot be regarded as levied on the richer classes; for it is paid, not out of the employer's private income, but as part of the cost of production out of business funds. It thus goes into selling prices, and the rich and the poor pay for it in proportion to the quantities of goods they buy.

As for the State's contribution, it cannot be taken as being a simple transfer of income from the rich to the poor. For the poor as well as the rich pay taxes, and a very large proportion of indirect taxation especially falls on the relatively poor. Moreover, in these days, when income tax is levied on a high proportion of the working population, the extent to which even direct taxation used to finance social services is re-distributive depends on the steepness of graduation of the taxes on incomes, and not on the mere fact that the taxation is levied directly.

These considerations explain why the great growth of the social services in recent decades has not involved anything like an equivalent re-distribution of incomes between rich and poor. The rise in earnings in war industries and the very steep graduation of income taxes during the war undoubtedly produced a re-distributive effect, offset only in part by the wide extension of the income tax to the bulk of the wage-earners and the very steep rise in the taxes on beer and tobacco. But before the war the growth of the social services was being paid for largely out of contributions levied on the workers themselves, and out of indirect taxes and employers' contributions, which swelled the cost of goods largely consumed by the poor. This explains the apparent paradox that the returns showing the distribution of property at death, compiled for the purpose of collecting death duties, showed but little change in the distribution of wealth between the 'Two Nations'. There was, indeed, an appreciable tendency for the groups nearer the middle to gain at the expense of the two extremes of great wealth and dire poverty; but even this tendency was not very marked.*

* See, for a discussion of this problem, *The Condition of Britain*, by G. D. H. and Margaret Cole (Gollancz, 1937).

There are, it must be admitted, difficulties under the existing economic system in carrying the re-distribution of incomes through taxation to very great lengths, though I should by no means agree with those who argue that the continuance of high taxation on large incomes since the war has had adverse effects on productive effort. It is not true, as is sometimes alleged, that a high level of taxation on incomes in itself acts as a deterrent to production, at any rate when the taxes are directly levied on the larger incomes. Personal income tax and surtax and death duties do not fall on the costs of production: they are levied on private incomes *after* profits have been distributed, and do not affect the prospective profitability of production to the *firm*. They may, no doubt, cause some owners of capital to prefer to live in countries where taxes are lower and to carry on production there. But the owner of capital cannot escape taxation by moving his business abroad unless he also moves himself: he may even run the risk of being taxed twice, both by the country in which he lives and by that in which his profits are made. The 'bogy' of the 'flight of capital' from countries which impose high direct taxation is a 'bogy', and not much more.

Nevertheless, in indirect ways, a high level of direct taxation may react unfavourably on the working of the capitalist economic system. In the last resort, the incentive to the capitalist to undertake production and employment is the *net* return which he expects to get; and if this *net* return is lowered he may be less willing to invest new capital. A high level of direct taxation may thus have some effect in aggravating any tendency towards a gap between the attempts of income-receivers to save out of their incomes and the willingness of business men to apply these 'savings' to real investment in new productive assets. But against this effect has to be set that of the higher demand for goods and services which will arise if the State uses the money raised by steeply graduated direct taxation in such ways as will add to the consumption of the relatively poor. When goods and services are made directly available for consumption, in such services as free education, school meals and milk, recreation-grounds and other amenities of living, or as subsidized houses or supplies of standard necessaries, the stimulus to consumption is unqualified: where money drawn by taxation from the rich is handed over to the poor as freely spendable income the effect will be largely the same, and the 'propensity to consume' will be increased. To the extent to which monopolists are allowed to hold up prices, the effects of any given money transfer will be impaired;

for an improvement in money demand will provide them as well as others with a means of charging more for their goods. On the whole, however, such transfers will have beneficial effects when the 'propensity to consume' is unduly low; but even in such cases their value will depend on the real incidence of the tax system being such that the richer classes do pay the cost and are not able to pass on their burdens to the poor.

Evidently, the more effective measures of re-distributive taxation and public expenditure seem likely to be in achieving their ostensible purpose, the more will they be opposed by the owners of property claims. Modern States have not found it easy in practice either to prevent the growth of monopolies or, except as an outcome of war, to place effectively high burdens of taxation on the rich. For example, the launching of a big public housing campaign after the first World War was immediately followed by a sharp rise in the prices of many building materials, which were under the control of close rings and associations; and in one case after another the levying of higher taxation on rich people through the budget has been balanced by the exaction of higher indirect taxes or, outside the budget, of larger sums in insurance contributions falling directly or indirectly on the poorer classes. This is not to say that the real re-distribution of incomes through taxation is impracticable, but only that it is bound to require exceptional conditions, such as those of war, to make it effective unless it is accompanied by other stringent measures of public control. In France attempts to tax the wealthier classes have met with singularly little success.

What other methods are there, besides minimum-wage laws and re-distributive taxation, for securing a better distribution of incomes in the community? A third way is that of trying to reduce the gross return on capital, instead of merely seeking to reduce the net yield by taxation after profits have been distributed. This can be attempted by operating on interest rates, so as to keep them as low as is conveniently possible. During the great slump of the 'thirties and again between 1945 and 1951, it was, on the whole, the aim of the British Government to maintain a régime of 'cheap money', in the hope of stimulating investment in new capital goods. This policy was not aimed directly at bringing about a re-distribution of incomes; but it is evident that, to the extent to which less had to be paid for the use of capital, there would be a larger proportion of the total product available for payment to the other factors of production, of which wage-labour is by far the most important. Thus a 'cheap

money' policy, if it succeeds, will not only increase consuming power to the extent of the addition to the consumption of the workers taken on in the industries producing capital goods and of the further additions to demand which will result from the transfer of the money spent in this way to other recipients (i.e. what is known as the 'multiplier'*), but will also tend to bring about a more favourable distribution of the product of industry by reducing the claim of capital to a share in the value created.

This, of course, is on the assumption that 'cheap money' spreads through the economic system as a whole. The 'cheap money' is, in the first instance, merely bank credit available for borrowing—that is to say, money available mainly for short loans, and not for works of long-term capital construction. If the Central Bank makes 'cash' plentiful as a basis for credit, and the commercial banks follow its lead in adopting a policy of 'cheap money', there will be reactions on long-term rates of interest, which should also tend to fall unless they are being held up artificially. But this reaction is by no means certain or automatic. It is possible for long-term rates to remain high, even when short-term rates are low; for though to a limited extent borrowers can shift from the one market to the other, they cannot do this beyond a certain point. It is easiest for the State to influence the long-term rate where there are public loans repayable at its option; for it can then offer to convert such loans to a lower rate of interest for a fresh term of years. If the lenders refuse, the State can then repay them with funds borrowed at low rates in the short-term market (e.g. Treasury Bills or short-dated Treasury Bonds), and can thus leave them with funds on their hands to re-invest under conditions which will probably force them to accept lower long-term rates. This was the situation in 1932, when the Treasury was in a position to redeem a maturing loan of £2,000 millions bearing interest at 5 per cent. The conversion and repayment operations in connection with this vast loan effectually lowered long-term interest rates, and had much to do with stimulating the ensuing boom in the building industry, which is greatly affected by the level of long-term interest rates. States, however, are seldom so

* By the 'multiplier' is here meant the secondary effect on consumers' demand resulting from the increase in wage-incomes of those directly employed. The spending of these incomes stimulates demand, and thus brings more labour into employment. This in turn produces further favourable reactions of the same sort. The 'multiplier' expresses the total of all these favourable effects. Thus, if the initial employment of 100 men causes a further 100 to be employed when all the indirect reactions have taken effect, the 'multiplier' is said to be 2. See page 140.

strongly placed as this for affecting long-term rates; and accordingly a policy of 'cheap money' may be for a long time ineffective in forcing down such rates. Where this is the case, the consequences outlined in the preceding paragraph will, of course, not follow. The 'cheap money' must spread to the long-term rates in order to produce its re-distributive effects.

Even if it does so spread, it will fail in part of its effect wherever monopoly is strong. Ordinarily, there is an interaction between interest rates on borrowed money and the expectations business men and investors entertain of the profits to be derived from using their own capital or investing it in company shares, as distinct from bonds or debentures. A person with money to invest can choose between lending it out at interest and investing it in the hope of profit. If the offered rates of interest are low, there will be a tendency for lenders to shift over to profit-seeking investment at lower expectations of profit than they would require if interest rates were high. Where, however, monopoly prevails, the monopolists may prefer not to receive fresh capital entitled to participate in profits, but to borrow what they need at interest and keep the profits for themselves—i.e. for the existing owners of their 'equity' capital in shares bearing a variable dividend. This will prevent the lower profit-expectation of lenders from adversely affecting the profits earned on existing capital. It is of course merely one instance of the general tendency of monopoly to shift the distribution of income in favour of the monopolists against the rest of the community. In the absence of such monopolistic influences, low rates of interest can be confidently expected to lower the profit prospects which will suffice to attract investment to shares bearing a variable return.

The effectiveness of a 'cheap money' policy in bringing about a re-distribution of incomes, limited at best, is thus further dependent on the monopolistic influences not being so strong as to be able seriously to distort its working in their own favour. To the extent to which it is distorted, the consequence will be a growth of 'windfall' profits, which, far from improving the distribution of incomes, will make it worse.

A fourth method of altering income distribution is by the remission of taxes, as distinct from the imposing of new ones, which we have considered already. Some economists have favoured a policy of tax remissions in slump periods, as a method of stimulating industrial activity. Such a policy has, however, two sides, according as the incidence of the remitted taxes is mainly on the rich or on the

poor. One proposal that is often made is that, in bad times, the State should remit the taxes on company profits placed to reserve, and perhaps even refund tax paid on reserves in previous years, on condition of the reserves being spent on new capital investment. Such a policy might obviously stimulate capital investment at a time when it was at a low level; but its re-distributive effect would be that of giving more to the rich. The owners of 'equity' shares are predominantly well-to-do people (though of course the number of small shareholders in individual concerns is large*); and the effect of such a remission of taxation would be to add the amount remitted to the value of the shares, and thus to make a large present of public money to the shareholding class. Similarly, if remission of taxes on incomes were so adjusted as chiefly to reduce the steepness of graduation, the effect would be that of re-distribution of incomes in favour of the wealthier classes.

This holds good even if the State does not replace the remitted taxes by others falling on the community as a whole in the same proportions as the entire tax system before the remissions. Even if the State, as is usually recommended, were to cover by borrowing the budget deficit resulting from the remissions, the effects of the re-distribution in favour of the rich would remain, unless provision were made to recover the same amount *plus* interest in later years from the same classes of taxpayers as had benefited from the remissions. The Swedish Government did carry out a policy more or less of this sort during the 'thirties; and it seems to have worked well. But a programme designed to recover in subsequent years the sums remitted, and to do so at the expense of the very classes which benefited, will obviously meet with a less enthusiastic reception in business circles than one which makes the remission virtually a gift outright.

It is far less often proposed to meet slump conditions by remitting taxation which falls chiefly on the poorer classes. Yet this is clearly what ought to be done, if the direct purpose is to stimulate consumption rather than investment. It is one of the merits of the post-war Social Insurance Scheme that it involves paying out in benefits in bad times more than is being currently taken into the Social Insurance Fund, whereas in good times the Fund's receipts will

* A great deal of nonsense has been talked about the immense number of small shareholders in big business. As most shareholders, small as well as large, spread their risks by dividing their investments among a number of concerns, the big totals often quoted are arrived at by counting the same persons many times over.

exceed its outgoings. It is indeed a sign of some progress in economic thought that this is now widely regarded as a merit, whereas when in 1931 the Unemployment Fund was paying out much more than it was receiving, reactionary critics loudly proclaimed this fact as a sign of impending national bankruptcy. Tax remissions to relatively poor taxpayers (or, of course, to payers of compulsory insurance contributions, which are in effect taxes) in bad times are a valuable way of maintaining the level of consumption: whether they should be recovered subsequently by higher taxation in better times merits further discussion.

Tax remissions differ in no respect from presents of purchasing power to those who benefit by them; but the benefit, of course, accrues to those on whom the remitted taxes would have fallen. In general, tax-remission policies can be more easily applied to direct than to indirect taxation in periods of slump, because the level of indirect taxation (except purchase taxes) is usually governed largely by protective or moral motives as well as by considerations of revenue, and there is strong resistance to any lowering of import duties or of excise duties on drink or tobacco when employment is bad. There are also political difficulties in the way of reducing insurance contributions in bad times, when insurance funds are paying out more than they are getting in. Accordingly, apart from purchase taxes, the taxes which are politically most open to reduction are taxes on income. These, however, are not paid by the poorest strata of the population, and, even when they have been extended to cover large bodies of wage-earners, fall, on account of their graduation, most on the larger incomes. Consequently, policies for the remission of taxation are apt to resolve themselves into measures of relief for the richer, rather than for the poorer, taxpayers; and this means that the effect of remission is smaller than it would otherwise be in increasing total consumers' demand.

There remains the proposal to improve the distribution of incomes by increasing the amount of direct money payment made to the general body of consumers, and financing this increase not out of the proceeds of taxation or out of borrowing to meet a budget deficit, but through the direct creation of additional purchasing power. Proposals of this kind have often been linked with the view, which we have already examined, that there is an inherent tendency in the existing monetary system to engender a 'deficiency of purchasing power.' This deficiency, it is alleged, can be made good only by a policy of 'social dividends', financed not out of existing

incomes by taxation or borrowing, but out of 'new money' created for the purpose.

I have tried to show reasons for rejecting the view that there exists any general tendency for the total quantity of purchasing power generated in the economic system to be too small to purchase the current product at a price sufficient to cover its cost, while accepting the view that there may exist temporary deficiencies (or temporary surpluses) of purchasing power, and also the view that hoarding or a deficiency of investment projects may cause the sums actually offered by purchasers for the current output to fall a long way below its cost. If these conclusions are correct, it follows that additional creation of purchasing power out of nothing would result in a surplus of spendable income above the cost of current output, and would thus tend, unless it were offset by equivalent hoarding, to raise prices or, if prices were pegged at their previous level, to leave over a surplus of spendable income which could not be used in buying currently produced goods and services. It is, of course, quite true that the putting into the people's pockets of this additional spending power could, if it were done at a time when there were productive resources lying unused, stimulate additional output. But the making of this output would itself involve the creation of additional incomes in the hands of the producers; and these incomes would then be available for spending over and above the specially created supplies of purchasing power. Accordingly, there would be a tendency for prices to rise, as the total spending power available would have increased faster than the total supply of goods and services. The additional purchasing power would therefore need to be recalled as soon as it had fulfilled its purpose of stimulating the additional production, unless it were regarded as desirable or harmless to allow prices to remain at the higher level. This might be desirable if, at the time when the fresh money was introduced, prices had been artificially depressed below costs (including reasonable profits) over any wide area of industry. In that case it would be necessary only to limit the additional creation of purchasing power to the sum needed to raise prices to the level regarded as suitable, and no provision would need to be made for repaying the money thus created. If, however, more money were created in the first instance than would suffice to sustain the desired level of prices, it would be necessary to provide means for the cancellation of the excess as soon as it had fulfilled its original purpose. It has, of course, to be borne in mind—though some monetary reformers seem

strangely inclined to overlook the fact—that spending power once created does not perish when it has been expended by its first recipient, but, unless provision is made for its cancellation, goes on circulating indefinitely from hand to hand; so that each additional unit created does not replace, but is added to, the previous units. This is not the case with bankers' credits, because they do have to be repaid to the banks; but it would be the case with non-repayable grants of income financed out of specially created money paid out by the State.

It follows from what has been said that, given initial conditions of full employment, there can be no place for 'social dividends' created out of nothing, and not financed by the withdrawal of purchasing power either by tax or by loan from some existing possessor of it. On the other hand, where unemployment does exist and there are unused productive resources which can be brought into use, there may be a case for such a policy; but it is not possible, even so, to carry it into effect without raising prices.

There is, indeed, a special form of the policy of 'social dividends' —a form in which I have myself advocated them for many years— which is not open to the objection just raised. It would be fully practicable, under the appropriate set of social and economic institutions, instead of paying out the whole of the net revenue generated in the course of production in rent, interest, wages, salaries and profits, to deduct at source a part of this revenue and pay it out, not in rewards to the owners of the factors of production, but as 'social dividends' to all members of the community as their common birthright in the collective productive capacity of the economic system. Current productive power is, in effect, a joint result of current effort and of the social heritage of inventiveness and skill incorporated in the stage of advancement and education reached in the arts of production; and it has always appeared to me only right that all the citizens should share in the yield of this common heritage,* and that only the balance of the product after this allocation should be distributed in the form of rewards for, and incentives to, current service in production.

In effect, something very like this occurs to-day in the Soviet Union, though the payments do not take the form of money dividends. The Soviet Union raises a large part of its public revenue by levies on industry, which are paid to the State as prior charges

* Family allowances can be fairly regarded as a first instalment of such a policy.

before incomes can be allocated to the producers or reserves accumulated by the industrial enterprises. The sums thus levied on industry go to meet the costs of government; and in these costs are included social services which represent a substantial proportion of the real incomes of Soviet citizens. The Soviet Union thus in effect pays 'social dividend' in kind, and finances this by means of a levy on the turnover of industrial enterprises, thus abstracting a part of the revenue from the producers as such and paying it over to the whole body of citizens. 'Social dividends' in this form, as in that described in the preceding paragraph, are thus financed out of what is in effect a form of taxation, and not out of specially created money. Of course, in saying this I am not denying that the Soviet Union may in the past have met deficits by special creations of money. I know that it has; but the effect of its doing so was, and must have been, to raise prices, whereas 'social dividends' fully financed out of levies on the product of industry need have no such effect if they are offset by a corresponding decrease in the incomes paid out in wages or returns on capital.

It is, of course, necessary, as part of the policy described, to limit the incomes paid out to the producers and the sums placed to reserve by industrial enterprises (there are, in the Soviet Union, no recipients of interest or dividends directly out of the product of industry) to what is left after the sums needed for public purposes have been withdrawn. If wage and other income payments are allowed to rise beyond this point, the effect must be to increase prices; and the increase can then be attributed, at choice, either to the rise in incomes or to the incidence of the turnover tax. Control of the incomes paid to the producers is the necessary correlative of the policy of 'social dividends' in the form here under discussion; and I think it follows that such a policy can be adopted only under an institutional set-up which confers upon the State the final authority to regulate incomes and prices as well as to levy taxation—in other words, under a socialised, or at any rate a largely socialised, economic system. It would no doubt be possible in theory for an economy based mainly on private enterprise to control so thoroughly both incomes and prices of all kinds throughout the productive system as to make possible a policy of 'social dividends'; but I very much doubt whether it would be possible in practice. It may be claimed that to a great extent such controls were enforced in Nazi Germany even before the outbreak of war—though not, of course, in pursuance of a social policy even remotely resembling that of 'social dividends'. I

admit that the necessary controls could be exercised under some form of complete Fascist dictatorship; but I cannot imagine a Fascist dictatorship willing to exercise them for purposes of social justice.

We can now try to sum up the general conclusions which have been reached in this chapter. There are at least seven ways in which a Government which wishes to improve the distribution of income in a community can set about its task. (*a*) It can pass minimum-wage laws, and seek through wage regulation to establish a satisfactory minimum standard of living for all its *working* citizens; (*b*) it can use taxation as an instrument for the re-distribution of incomes, applying the yield of the taxes either to the provision of communal services, or to the making of social service payments in money to needy members of the community, or to the subsidization of necessary goods and services so as to increase the real incomes of the poor; (*c*) it can set out to reduce the proportion of the yield of industry accruing to owners of capital by measures designed to keep rates of interest at the lowest practicable level, and perhaps also by direct limitations on profits; (*d*) it can endeavour to mitigate the poverty arising in periods of depression by remitting taxes which fall heavily on the poorer classes, with or without provision for replacing the lost revenue by means of heavier taxation in prosperous times; (*e*) it can make direct grants of purchasing power to the poorer consumers, or to all citizens as a matter of right, and can finance these payments by borrowing from its own citizens; (*f*) it can make similar direct grants, financed, not by borrowing, but by new public creation of additional purchasing power. [This proposal, we saw, is usually put forward by those who believe that the existing economic system suffers from a tendency to an endemic, or at least a recurrent, deficiency of purchasing power]; (*g*) it can adopt a policy of 'social dividends', financed neither by creation of new purchasing power nor by borrowing nor by taxation in the ordinary sense of the term, but by a prior levy on all industrial turnover, with a consequent limitation of the incomes distributed as rewards for, or incentives to, production to what remains available after the share required for the 'social dividend' has been appropriated by the State.

I have tried to show both the effects of all these re-distributive policies and their limits, as well as the difficulties in the way of their adoption. They are not, of course, mutually exclusive: there is nothing to prevent a community from making use of several of them at the same time. Against the last, and to some extent against all of them, it is urged that the distribution of any considerable part

of the national income in the form, not of 'economic' rewards for work done, but of social payments based on needs or on civic rights, would react adversely on production, because it would lessen the incentives offered in the form of wages, profits and other incomes paid for the use of the factors of production. I feel sure this argument is not valid. The incentive to production depends in the main, not on the absolute magnitude of the rewards offered, but on their relation one to another. An offer of several thousands a year under one social system will provide no greater incentive than an offer of as many hundreds under another. Where great inequalities of wealth and income exist, as they do in feudal and in capitalistic societies which encourage large accumulations of property, it is necessary to offer large money incentives for the superior kinds of work. Where heavy costs of education and training fall on the entrants to certain professions, or where entry is open only to those who possess considerable capital, it is necessary to hold out the prospects of large gains. But the more nearly a community approaches to conditions of social equality, the smaller are the differences of income that will suffice to provide adequate incentives to effort.

If it were decided to institute a policy of 'social dividends', payable of right to all citizens as their shares in the common heritage, quite apart from the rewards accruing to them from their individual labours, it would no doubt be necessary to begin on a small scale—with payments that would not suddenly upset the whole structure of incomes derived from the various forms of productive service. But the system, once instituted, could be extended progressively, the monetary incentives needed to elicit effort falling as the community accustomed itself to the idea of greater equality and of a right to 'dividends' as attaching not to the owners of capital, but to all the citizens as their participation in their common birthright.

To some of my readers, speculations of this order will doubtless appear Utopian, and out of place in such a book as this. But is the idea of a 'social dividend' so far away from the spirit of a part of the post-war social programme endorsed by the British electorate in 1945 and subsequently put into effect—a programme in which the notions of comprehensive free medical services and comprehensive free education were decisively stated and approved? If the State assumes the responsibility of seeing to it that all its citizens are to be given the chance of free health services and of free education at the secondary as well as the elementary level—if it is to go further, and to accept the implications of the Beveridge slogan 'Freedom

from Want'—what is there Utopian in suggesting that a share in the product of industry ought to accrue to every citizen as a money payment which he can spend freely, as well as in the form of certain freely provided services? It is a further step, I agree; but it is a step on a road on which we have already agreed to travel a good deal of the way.

In this chapter I have been discussing the re-distribution of incomes, not mainly on its merits as a social policy, but in relation to its use as an instrument for correcting economic instability. But of course the possibility of employing it for this purpose is not the main reason for wishing to bring it about. It is desirable for its own sake—or rather for the promotion of human happiness and welfare—to the fullest extent to which it can be made compatible with the maintenance of adequate incentives to production. Class-inequality is a social evil which we ought to set out to eradicate as far as we dare; and it would be a disaster if we were to get rid of the gross inequalities arising out of private exploitation of the resources of production only at the cost of a 'managerial revolution' that would establish no less gross inequalities in a different form.

VIII

THE DEMAND FOR CAPITAL—PUBLIC WORKS AND THE CONTROL OF INVESTMENT

THE preceding chapter dealt entirely with methods. It discussed how Governments could set about altering the distribution of incomes in the community to the advantage of the poorer classes, if that were what Governments wanted to do. Now, the desire to bring about a less unequal distribution of incomes may be based either on considerations of social justice or on the belief that the uneven distribution is a cause of economic disequilibrium and depression—or, of course, on both considerations taken together. The argument from social justice can be given an economic shape by demonstrating that on account of the 'diminishing marginal utility of money' * a more equalitarian distribution is likely to achieve a greater total of 'utility' or 'value in use' than a less equal distribution. If value is something subjective, consisting in the amount of satisfaction derived from an output of goods and services, the total value created will be at its maximum if the available supply of goods and services can be distributed with as near an approach to equality as is compatible with retaining the incentives necessary to secure a satisfactory volume of output.

It is, of course, bound to be a matter of opinion, both what degree of inequality is necessary for the maintenance of the incentives to labour, and how much diminution of output it is worth risking (if there is such a risk) in order to achieve a more even distribution

* By the 'diminishing marginal utility of money' is meant that, as consumers must be regarded as setting out to satisfy their more urgent needs before the less urgent, the more purchasing power they have the further they will be able to go in satisfying less urgent needs. Thus, the demands which they would abandon first if their purchasing power were reduced involve less sacrifice of utility for each shillingsworth than the demands they continue to make when they can buy less in all. No doubt, in practice, consumers may continue, when they suffer a loss of real income, to spend some of their money on what social moralists regard as 'luxuries', at the cost of going without what these moralists regard as 'necessaries'; but presumably the consumers behave in this way because they value the 'luxuries' more highly than the 'necessaries'. A certain amount of 'luxury' spending may satisfy a psychological need of great intensity. The conception of the 'utility' of money to the consumer is based not on what, in the moralists' opinion, he ought to want most, but on what he does actually prefer when he has to make a choice.

of purchasing power. It may be that the highest level of total output will be promoted by a much nearer approach to economic equality than we have yet achieved; or it may not. It may be, as I believe, that the degree of inequality needed to provide adequate incentives depends on the general character of the social system, and cannot be determined apart from the character of the social institutions within which the incentives are to be offered. To the extent to which greater equality increases total output, greater equality is clearly desirable on economic grounds. To the extent (if any) to which we cannot have greater equality without adverse reactions on total output, there is no way in which an *economic* judgment can be reached. Society has to settle for itself, with no economic rule to govern its decisions, which it values the more highly—more in total output, or a more even distribution—and how far it thinks fit to carry its preference in either direction.

The principle of the 'diminishing marginal utility of money' can also be stated in this way. When a person has reached the point at which his income suffices to provide him and any dependants he may have with the means of tolerable living, each *money unit* added to his income tends to be of less value to him than the preceding units in terms of the satisfaction it affords. An additional shilling obviously means little to a millionaire, but a great deal to a poor man who has but a narrow margin above the absolute necessaries of life.

This is plain common sense; and no one in his senses will question its truth unless he is being disingenuous. It is quite true, as a number of economists have urged, that there is no way of measuring exactly *how much* more satisfaction an extra shilling gives to one person than to another, and also that different persons in the same economic position do not necessarily enjoy the same, or equal, satisfactions. Satisfaction is a psychological state, is affected by many non-economic considerations, and does not admit of exact measurement. But it is nonsense to suggest that, because we cannot measure satisfactions, we have no right to say that an extra shilling will tend to give more satisfaction to a poor man than to a rich man who is already in a position to buy all the satisfactions he can effectively enjoy. We can no doubt imagine exceptional cases—the extravagant joy which a mad miser might experience in getting possession of the last shilling in the world, or the cynical flinging of a shilling into a ditch by a man so desperately poor as to think it useless. But it is not suggested that on every occasion every poor man will get

more satisfaction out of his extra shilling than any rich man can ever get. The contention is merely that in general we can safely act on the assumption that, the smaller the incomes people have, the greater satisfaction they will be likely to derive from each shilling or pound added to their incomes.

The argument from social justice and the principle of the 'greatest happiness of the greatest number' thus lead straight to the common-sense practical conclusion that the less economic inequality we have to tolerate in order to maintain total production at a satisfactory level, the better off we shall be. The argument leading to this conclusion is, however, quite distinct from the argument that, unless we achieve a nearer approach to equality than has been achieved in the capitalist societies of to-day, we shall find production upset by recurrent crises of under-consumption, and shall thus in fact lose the benefit of the higher output which economic inequality is supposed to promote.

This 'under-consumption' argument takes two forms, one of which we have examined already. Stress may be laid, as it was by Keynes, on the phenomenon of 'under-investment', or, as it was by J. A. Hobson, directly on 'under-consumption' of consumers' goods. The two views appear at first sight to be sharply opposed; but, when they are examined, we find that they have much in common. For why does 'under-investment' occur? Clearly, because business men take an unfavourable view of the prospects of the profit to be derived from expanding output. Why do they take such a view? Clearly, because they doubt their ability to find buyers for the additional output at a remunerative price. In other words, they doubt whether consumers will be able or willing to consume as much as the productive system can put itself in a position to supply. The sole ultimate purpose of capital goods is to make consumers' goods or services,* and the sole limiting factor, within the available supply of factors of production and of capital for buying them, to the demand for capital goods is the size of the market for the consumers' goods which, directly or indirectly, the capital goods can be used to produce. In other words, if business men fail to take up and spend on new capital investment as much money as would-be savers are ready to place at their disposal, the reason is that they fear the limitations of the market for consumers' goods.

'Under-investment' thus depends on 'under-consumption', or

* Including, of course, those which are collectively provided and consumed, such as roads and schools—and armaments.

rather on the expectation of it in the minds of business men. On what, then, does 'under-consumption' itself, in the narrower sense of a deficient market for consumers' goods and services, depend? Hobson argued that it depended, not on any persistent tendency to a deficiency of total purchasing power, but on the maldistribution of incomes, which led to an attempt, over the community as a whole, to save an excessive proportion of total income. The consequence of this relative 'over-saving', he argued, was that the income applied to the purchase of consumers' goods and services tended to be too little to afford openings for the remunerative investment of all the money which the community, mainly through its richer members, was attempting to save. The investment of all this money in new productive instruments would be bound to lead to a glut of consumers' goods, with the result that many of the less efficient businesses would be driven into bankruptcy, and a spreading crisis would develop, as the bankruptcy of some concerns led to the bankruptcy of others to which they owed money, and so on in a widening circle of chaos and unemployment.

Keynes does not appear to have questioned the fundamental part of this argument, although he stated the position differently. He stressed, as we have seen, the point that at times of economic depression a substantial part of the 'savings' which people try to make will not get *invested* at all in new instruments of production, and will therefore be wiped out by business losses which will necessarily arise from the withholding of a part of current income from spending either on currently produced capital goods or on consumers' goods and services. Clearly, in fact, either or both of these situations may arise. There may be either, as Hobson argued, a glut of productive instruments in relation to the state of consumers' demand (what business men call 'redundant capacity') or a failure to invest in new capital goods, resulting in losses spread over the entire business world and in serious unemployment spreading from the capital goods industries to those producing consumers' goods.

Hobson's argument appeared to point to the conclusion that the appropriate remedy for economic depression was to be found in a better distribution of incomes, leading to the expenditure of a higher proportion of the national income on consumers' goods and services, and to a fall in the rate of saving. Keynes suggested at first sight that the remedy lay rather in taking measures to expand the demand for capital goods, both by appropriate monetary measures and by the intervention of the State to offset any falling short of private

investment by increasing the community's capital equipment. This could be done by undertaking extended Public Works, either directly or through local authorities or Public Corporations acting under state influence and control.* Keynes, however, also laid stress on the effect of full employment in maintaining consumption, and on the effect of low interest rates in stimulating the 'propensity to consume', and opposed the notion that economic activity could be stimulated by reducing money wages.

If, as Hobson's argument suggests, the capitalist system tends, on account of the maldistribution of incomes, to 'over-saving', or, as Keynes would prefer to call it, 'attempted over-saving', it seems at first sight more appropriate, when depression threatens, to adopt measures which will directly expand consumption at the expense of saving than to resort to artificial stimuli to investment in capital goods with the object of ensuring the investment of all the money people try to save. Yet many persons are reluctant to accept this conclusion because they are unwilling to endorse the view that the community can be attempting to save too much. Thrift has been cried up so much as a virtue that any argument which throws doubt on it meets strong psychological resistances. Moreover, it seems to be plain common sense that the more capital a community can accumulate the richer it will be in a position to make its citizens. After all, the vast majority of people have still grossly inadequate incomes; and it seems evident that there *ought to be* no difficulty in disposing usefully of any increased output made possible by increased investment, no matter how large this investment may be.

Yet it is also plainly true that investment cannot be remunerative unless there is a sufficient expansion of consumers' demand to absorb the additional output as it comes on to the market. The community can, by abstaining from consumption to-day, and investing instead, make itself richer for to-morrow; but it can do this only on condition that, when to-morrow comes, it does consume the additional goods which the investment of yesterday has placed at its command. If it fails to do this, the investment is stultified. A community cannot go on indefinitely storing up jam for to-morrow: it must some time take its jam to-day.†

The problem, however, is not in reality so simple as this makes

* This public investment could, of course, be used to increase the supply of durable consumers' goods, such as houses, as well as of capital goods in the narrower sense.

† Or, of course, *give it away* to countries whose inhabitants need it more.

it sound. Investments of different kinds take very different periods to mature. Investment in tree-planting, for example, takes a very long time to yield any consumable product. The building of a railway through potentially productive but largely uninhabited country will be remunerative only after there has been time for the new lands to be settled and opened up. The Soviet planners, in the early years of Soviet development, built power-stations of a size and capacity which they could hope to exploit fully only after they had gone a long way in expanding the industries which these stations were to serve. Investments of these types involve abstention from current consumption over long periods. On the other hand, a house can be lived in as soon as it is built; and machines for manufacturing consumers' goods can begin producing as soon as they are installed. Such investments also involve abstention from current consumption, because they take away man-power and other resources which could be used for making consumers' goods which would be more speedily available. But the period of deferment is much shorter. In any case, delivery of the goods must be taken when they are ready, or the investment will be wasted; but delivery may come soon or late.

Does this mean that there are limits to the extent to which a community can abstain from consumption in the expectation of securing thereby an expanded supply of consumers' goods in the future? Yes, it does, where the community is self-contained. But wherever there exists a possibility of capital export on an unlimited scale, abstention from current consumption in the expectation of future benefit can be pushed very much further than it can in an economy which lives by itself, or conducts its foreign trade only on a basis of mutual exchange. If the possessors of investable capital are able to invest it abroad, and can find markets both for their capital and for the goods which will be produced abroad with its aid, they can go on investing as high a proportion as they please of their incomes, without being pulled up short by the necessity of finding *in their own country* consumers for the products of their capital goods.

It was, of course, this process of foreign investment that, through most of the nineteenth century, provided an outlet for all the capital British property-owners chose to save beyond what was needed for the expansion of industry to meet the demands of the home consumers. This overseas investment provided a large fraction of the employment in the industries producing capital goods, and also

accounted for some of the employment in the industries producing consumers' goods; for a part of the exported capital went out in the form of consumers' goods bought, directly or indirectly, out of the wages and other incomes paid to those engaged on overseas capital works financed with British money. No doubt, the interest and dividends on these accumulating investments were due to the British owners; but in the main the sums received in these forms were re-invested abroad, so that no net supply of consumers' goods came into Great Britain in payment for them. As long as these conditions lasted, there was no limit to the amount of saving and investment that the British economic system could engage in without any necessity of raising its standards of consumption so as to purchase the products of its investments as they were put on the market. No doubt, standards of consumption did rise in Great Britain; but this happened because of technical advances in the arts of production all over the world, and did not involve any need for home consumption to be specially expanded to meet the increasing product due to overseas investment.

In these circumstances, it is not surprising that nineteenth-century economists continued to find in thrifty saving the first of economic virtues and the key to progress, long after the period of home scarcity of capital which characterized the earlier stages of the Industrial Revolution was over and done with. Our grandfathers and great-grandfathers had no doubt in their minds that the person who set aside from expenditure on current consumption, and thus saved, a part of his income was a benefactor to society, or that the accumulation of capital by this method on the largest possible scale was the right way of ensuring higher standards of living for the future. It was obviously true that the individual who saved was usually able to pass on the benefit to his children; and it seemed natural to conclude that what was true of the individual must hold good for society as a whole—for what was society, except the aggregate of all the individuals who made it up? The classical economists took it for granted that under normal conditions all the sums set aside by individuals would find their way into investment in real productive assets—unless indeed they were frittered away by the State in war—and they further assumed that this process of investment would render improved technical methods of production continually practicable, and would thus lead to a continual cheapening of production and to a progressive advance in national wealth. Only their heterodox critics questioned these assumptions, laying

stress on the phenomenon of 'over-production' or 'under-consumption'—which side they stressed depending on the aspect from which the occurrence of economic crises was regarded. The main current of classical economic theory swept past such criticisms, and regarded crises as abnormal occurrences, on which no general theory of economic processes could be based. After all, on the whole, societies did get wealthier, and there was no sign of the advent of that 'increasing misery' which the critics of capitalism had predicted. Standards of living did rise, with only brief interruptions, in all the advanced capitalist countries through the greater part of the nineteenth century: orthodox believers in the theory of the Wages Fund saw in the growth of capital the means of employing more labour, and, when that theory was discarded in favour of 'productivity' theories, the highest possible rate of saving still seemed to offer, by cheapening production through more intensive applications of capital, the best assurance of rapid economic advance.

This attitude was widely acceptable because, as we have seen, the nineteenth century's appetite for additional supplies of capital seemed to be insatiable. Over the century as a whole, the process of capital accumulation, interrupted though it was by recurrent crises and depressions, went on at a prodigious rate in comparison with anything the world had known before. A large part of this accumulation took the shape of investment in the home industries of the more advanced countries; but a considerable, and an increasing, share went into the development of areas overseas. Investment beyond the seas formed, indeed, an important means of maintaining the demand for the products of the industries making capital goods whenever home demand for a particular kind of product fell off. For example, when the work of building the network of the British railways had been mainly done, and the demand for renewals was diminished because steel was more durable than iron, the construction of railways first in the more populous foreign countries and then all over the world provided alternative employment for the resources of the great firms of railway engineers and contractors; and later in the century firms which had begun by building bridges, water-works, gasworks, and other public utility installations in Great Britain found new outlets for their enterprise in the undertaking of similar works of construction in foreign parts—including, of course, the countries of the British Empire. Overseas investment, as the concomitant of the export of British-made capital goods and British engineering skill, more and more took precedence in the

London capital market over investment in home industries, which financed themselves to a growing extent out of their own profit reserves.

We have seen that this export of British capital stimulated the demand for exports, not only of capital goods, but of consumers' goods as well. Loans made by British investors were used not only to pay for the still, for the most part, unrivalled products of the British steel and engineering industries, but also to pay wages and meet other charges in the borrowing countries, with the consequence that the recipients spent a substantial part of them on British textiles and other British-made consumers' goods. British investors supplied a good deal of the working as well as of the fixed capital for overseas economic development; and as long as these conditions continued, the export of British capital and the export of British manufactures advanced by parallel steps. Only as other countries developed their own competing manufactures of both consumers' goods and capital goods did it cease to be true that loans of British capital overseas carried with them a practical assurance of orders for British exports, and that foreign purchasers bought British goods not merely in exchange for their own products sold in the British market, but with British money lent to them without any formal restriction on their right to spend it where they pleased.

TABLE IX

British Overseas Investments at Long Term, 1870–1913

(Figures from Feis: *Europe, the World's Banker*)

	Annual Average £ millions		*Total Income from Foreign Investments £ millions*
1870–74	61		
1875–79	2		
1880–84	24	1883	50
1885–89	61		
1890–94	46	1891	100
1895–99	27		
1900–04	21	1903	115
1905–09	110	1907	140
1910–13	185	1913	205–210

These figures are only rough estimates.

TABLE X

Geographical Distribution of British Overseas Long-term Investments in 1913

Empire	*£ millions*	*Foreign*	*£ millions*
Canada and Newfoundland	515	U.S.A.	755
Australia and New Zealand	416	Argentina	320
South Africa	370	Brazil	148
India and Ceylon	379	Mexico	99
West Africa	37	Rest of Latin America	190
Malaya	27	Russia	110
Rest of Empire	35	Rest of Europe	109
		Japan	63
		China	44
		Egypt	45
		Turkey	24
		Rest of Foreign World	78
	1,779		1,985

Grand Total, £3,764 millions; yielding an income of from £205 to £210 millions.

This process of high capital exports from Great Britain lasted right up to 1914. The first World War cost the country a substantial fraction of its overseas investments, many of which had to be sold to meet the bill for war imports. Export trade inevitably declined under war conditions; and though, when the war was over, the process of capital investment overseas was to some extent resumed, the scale was much smaller than before 1914. Nor was there the same assurance as there had been earlier that loans of money arranged in London for foreign borrowers would be spent on British-produced goods and services, and would thus give direct employment to British industries. As against this, there were at most times considerable funds belonging to foreigners left on deposit in Great Britain, and the presence of these funds, equivalent to temporary loans of capital to Great Britain, prevented the overseas loans granted in London from exerting as much pressure on the foreign exchanges as would otherwise have occurred. But making long-term loans on the strength of short-term borrowings or deposits is a precarious business; and the vulnerability of the post-1918 British system appeared in the crisis of 1931, when a flight of short-term money (both British- and foreign-owned) out of the country brought on an exchange crisis, and led to the abandonment of the

gold standard and to a sharp fall in the external value of the pound sterling.

After the crisis of 1931, Great Britain was no longer a considerable exporter of capital. As long as the world depression lasted, there was little temptation to investors to risk their money in foreign ventures; and even in the period of recovery in the middle 'thirties overseas loans were on a small scale and Great Britain, instead of having a substantial balance available for investment abroad, was actually re-importing capital as old overseas loans were paid off and not replaced. All the available supply of foreign exchange was needed to pay for British imports, despite the curtailment of manufactured imports by the tariff adopted in 1931-32, and also despite the fall in the prices of primary produce in terms of manufactured goods. Great Britain was getting imports on very favourable terms from the rest of the world; for the prices of British exports had fallen considerably less than those of British imports. But in spite of this, net overseas investment had disappeared, not through any lack of British manufacturing capacity, but because orders had fallen off.

It is difficult, in this development, to disentangle cause and effect. The fall in exports was neither the cause nor the consequence of the decline in overseas investment. It *was* that decline, expressed in real terms. If foreign buyers had wanted to buy more British goods, their willingness to buy would have created the export of capital needed to finance the purchases; for it would not have been difficult to provide the finance for firm export orders if they had been forthcoming. No net addition to the supply of foreign exchange would have been needed; for the goods exported would themselves have provided the requisite finance. At the same time, the lack of a 'favourable' exchange balance made it more difficult to push exports by providing ahead the finance needed for buying them; and the Bank of England, acting in consultation with the Treasury, was compelled, in order to protect the value of sterling on the world market, to exercise a *de facto* embargo on foreign loans, except a limited number which were approved for special reasons. Overseas markets ceased to provide as large an outlet for the products of the British industries producing capital goods as they had done in the past; and, because of this, the point was much sooner reached in a depression when the total volume of investment fell below the sums which the recipients of incomes were attempting to save, and the gap between attempted 'savings' and real investment appeared.

The question then was whether the sums no longer embarked in

investment overseas ought to be diverted to some form of home investment, or whether money savings ought to be curtailed in order to adjust their amount to the diminished investment demand. The former of these policies involved the finding of forms of real investment additional to those which would be embarked upon spontaneously by business men in search of the highest attainable profits. The advantage of 'public works', as an outlet for funds available for investment, was that, to a great extent, such works could be so arranged as to be non-competitive with privately owned industry, and indeed so as to provide employment for capitalist enterprise in the constructional trades. The State and the local authorities could carry out, as 'public works', projects of capital construction on which private enterprise would never have embarked, and could use on these works the services of private firms of contractors. The capital goods thus produced could be such as to enter little, or not at all, into competition with private industry in the markets to which it looked for its outlets, and could in some cases be of positive benefit to private enterprise by opening up new fields of investment and taking part of the cost of construction off the shoulders of the private entrepreneurs.

For example, when the State or the local authorities built roads, they made it cheaper and easier for private speculators to construct housing estates or to operate road-transport businesses. Indeed, the effect of public road-building was to encourage that form of ribbon-development which was so marked a feature of speculative building enterprise between the wars. The social disadvantages were serious; but the economic inducement to the speculative builder was a plain fact. Again, the State, by promoting the construction under a Public Corporation of the electricity 'Grid', gave a very welcome stimulus to the industries producing all kinds of electrical equipment; while public housing increased the demand for builders' materials, furniture, and other sorts of supplies.

One consequence of the attempt to provide outlets for home investment without entering into competition with privately owned industries was that a great stimulus was given to the production of durable consumers' goods—above all, houses. Public enterprise in this field used the services of the private building firms; and, apart from this, the fall in interest rates and the availability of large funds seeking investment led to an immense expansion of the Building Societies, which provided the finance needed for estate development on a great scale. Housing, especially where it could be carried out

by private builders financed by Building Societies without state subsidy, provided a very convenient means of taking up the slack in economic activity. The disadvantage was that the houses built by this method were too expensive for any except the top section of the working classes; and there were many signs before 1939 that, except in a few areas, the demand for houses to be acquired by instalment purchase through Building Societies at current costs was nearing exhaustion, and that there was impending a sharp fall in house-building activity unless the State came in afresh with large projects of subsidized development. However, during the 1930s the State was largely relieved from strong pressure to resort to public works by the rapid growth of 'private enterprise' housing under the stimulus of low interest rates and of intensive efforts on the part of the Building Societies to find uses for the huge sums which 'savers' were eager to place in their hands.*

The Treasury, for its part, took up at first an extraordinarily obscurantist attitude towards 'public works policy', when it argued, in the notorious Treasury Memorandum of 1929, that any form of public investment was bound to be offset by an equal fall in the volume of private investment. This was the merest nonsense, directed against Labour and Liberal plans for extensive public works designed to combat unemployment. Such works as I have instanced—and it would be easy to instance many more—far from reducing the amount of private investment, were bound to have precisely the opposite effect.

It is, however, true that there are kinds of public works which, even if they react favourably on some kinds of private investment, are unfavourable to other kinds. In the field of housing, for example, as long as the State confines its house-building activity to types of houses in which the private speculator sees no prospect of a satisfactory profit, and therefore does not supply, no considerable opposition to public provision of houses is likely to arise; but as soon as it begins to build houses of types which the private speculator thinks he may want to provide himself, the contest begins. To the actual builders, it makes no difference whether the houses are publicly or privately built, unless indeed the builder is also a speculator in house-ownership; for the State and the local authorities will in the great majority of cases use private building contractors to carry out the work. But it does matter to the speculative financial agencies

* For the investment in Building Societies during this period see the Table on page 220.

which depend on the development of private housing estates, as well as to the Building Societies and Insurance Companies which supply the capital for speculative building operations. Thus, in connection with further housing projects, these agencies were eager in the 1930s to confine public building to a narrow sphere—the erection of cheap working-class houses for letting by the week—and to keep in their own hands the main field of estate development, including the provision of all houses above a quite low rent or rateable value.

I have cited this example as illustrating very clearly the desire of advocates of 'private enterprise', while not opposing all public works, to limit the range of state intervention in the field of capital construction to projects which will in no way compete with their own activities. It must be obvious that, if the State's field of action is thus limited, it will be very difficult for it to find suitable projects for any really large development of 'public works policy', and that there will be a danger of the Government being forced, in its endeavours to increase employment, into undertaking projects not because they are the most useful or productive among those available, but rather because they are likely to arouse the least opposition. If this is allowed to happen, the effect must be to throw discredit on 'public works policy', which will even under these conditions fulfil its immediate object of providing additional employment, but will fail to give the public fair value for the sums expended.

The wider the range over which the State is free to select projects for the execution of public works, the more satisfactory the results are likely to be, from the standpoint of improving the capital equipment of the community. Recognizing this to some extent, the upholders of private, as against public, enterprise fall back on urging that the State, wherever it desires to step across the frontier-line into the sphere which the private capitalists regard as their own, should proceed by way of subsidy rather than by direct undertaking of public works, i.e. it should pay private enterprise part of the cost of the job, and then leave the finished product under private instead of public ownership. Again housing furnishes an obvious example. The Chamberlain Housing Act of 1923 offered a subsidy to anyone who undertook the building of a house, whereas the Wheatley Housing Act of 1924 confined its assistance to the local authorities, which became the owners of the houses built under its provisions.

The great difficulty about subsidies to private industry is that it is nearly impossible to pay them only to those who need them. If they are limited to stimulating investment which would not take

place without them, the effect is to make unprofitable forms of enterprise more profitable than forms of enterprise which would be sufficiently profitable if no subsidy were given. This leads to allegations of unfair competition, the subsidization of the inefficient, high-cost producer to the detriment of the efficient producer, and the disturbance of normal price-relations. Accordingly, the better-placed or more efficient producers demand to be subsidized equally with the less well placed or less efficient; and the State is usually forced to give way, and to make its subsidies available to all on equal terms. This renders a policy of subsidy exceedingly expensive, and presents large windfall profits to the better-placed producers. In effect, a large part of the money paid out by the State goes, not in stimulating additional investment and employment, but in wholly unproductive gifts to persons who do not need them.

The conclusion is that, if the State is to operate any extensive 'public works policy' with economy and efficiency, there must be at its command a wide range of investment projects on which it can embark in such a way that the benefit accrues directly to the public. This condition can be satisfied only if the State has under its control a fairly wide range of industries which are large users of capital goods. Housing is one obvious example, and, of course, civil engineering in relation to roads, bridges, waterworks, aerodromes, and other essential public utilities is another. But, over and above these, the effective working of a large-scale 'public works policy' can be much more easily achieved where a wide range of industries and services is publicly owned.

The rate of home investment that a country needs is affected by a number of factors. If its population is increasing, it has to make provision for the increase of output to meet growing demands, and this involves investment on a rising scale. When technical progress is rapid, instruments of production need to be scrapped before they are worn out; and this again involves high investment in new capital goods. Changing tastes, both at home and in foreign markets, involve the provision of new instruments of production adapted to the new demands. As against these factors, countries with stationary or declining populations can do with less capital accumulation than if their populations were increasing; and a slow pace of technical development or a conservative market demand has similar effects. Under conditions of war, some industries advance very fast; but because the main effort is concentrated on whatever is needed most for military success, most consumers' industries are starved of capital

and fall behind in efficiency. War, moreover, may cause extensive damage to buildings and equipment, and may leave a country with big arrears to be made up. After a great war, it is usually desirable to maintain a high rate of new capital construction in order to rebuild damaged and obsolete urban areas and to bring about a thorough renovation and readjustment of industries in the light of

TABLE XI

CAPITAL FORMATION AT MARKET PRICES

U.K. and U.S.A., 1938 *and* 1947–1952

		Total	*Gross Capital Formation*			*Depreciation†*	*Net Capital Formation*
			Construction	*Equipment*	*Stocks**		
U.K. £m.	1938	845	—	—	—	457	388
	1947	1,489	545	656	249	500	989
	1948	1,611	630	790	145	569	1,042
	1949	1,634	664	886	35	724	910
	1950	1,472	688	958	−225	816	656
	1951	2,327	732	1,077	465	902	1,425
	1952	1,900	2,000		−100	822	1,078
U.S.A. $m.	1938	9,982	6,980	3,975	−973	7,992	1,990
	1947	32,910	16,627	17,080	−797	14,845	18,065
	1948	46,549	21,572	19,948	5,029	17,612	28,937
	1949	39,004	22,789	18,697	−2,482	19,371	19,633
	1950	59,542	29,733	22,299	7,510	21,604	37,938
	1951	67,911	32,463	24,580	10,868	24,217	43,694
	1952	63,370	34,254	25,393	3,723	26,961	36,409

* Addition to (+) or Reduction in (-).
† For U.K., chiefly statutory allowances.

changing needs and world market conditions, as well as to make up for technical backwardness in many branches of production. When such periods of reconstruction are over it may be possible to return to a lower rate of capital accumulation. But whether this is desirable or not does not depend entirely on conditions within a single country. If there is to be a rapid and continuous industrialization of backward countries in Eastern Europe, Asia and Africa—including,

of course, the colonies now attached to the various empires—there will go with this development an active demand not merely for capital goods but for loans or gifts to enable the backward countries to acquire them without depressing the current living standards of their own peoples. The Soviet Union had, in the main, to carry through its extraordinary achievements in industrialization without aid from foreign capital, and had therefore to divert a large part of its resources away from the making of consumers' goods to works of capital construction. This meant, while it was going on, a terribly low standard of living for the Soviet peoples; and it was possible, on the scale on which it was done, only because the Soviet Union was lightly populated. To achieve the industrialization of Eastern Europe, India and China, with their crowded peasant populations, by similar methods would involve immense transitional sufferings, however much standards of living might be improved in the long run. Indeed, the attempts at rapid industrialization in Eastern Europe have already had to be slowed down on account of their unfavourable effects on the immediate living standards of the peoples concerned. Economically backward countries, if they are to embark on large development projects without great suffering, need the help of foreign capital; and it is obviously an imperative obligation for Great Britain to play its part in the provision of the needed capital, especially in the colonial areas attached to the British Commonwealth.

Great Britain, however, cannot do this unless it can find means, apart from the goods exported by way of gifts or loans, of exporting enough of its products to meet the cost of necessary imports of foodstuffs and materials—including the imported materials which will enter into the value of the goods exported as gifts or on loan. This is a formidable task; for considerable exports of capital goods as well as of consumers' goods from Great Britain are needed to balance the necessary imports. It will not be possible at all unless British industry can be raised to a very high level of efficiency, and kept continuously in a condition of full employment. British exports of capital goods, as well as of consumers' goods, will have to hold their own in a highly competitive world market; and the backward countries will be able to afford neither high prices for the goods supplied to them, nor high rates of interest on the loans made available for financing their purchase. These conditions call for a very extensive overhauling of British industrial equipment, in order to bring it thoroughly up to date, and also for continual ingenuity in

striking out on new lines of production, both to replace exports which the less advanced countries take to making for themselves and to keep British production abreast of changing demands in home and foreign markets alike. Moreover, if this process of world development sets in, the effect will be to keep the demand for capital investment high long after the period of immediate post-war reconstruction in this country has come to an end.

The problem is made the more difficult by the existence of a vast amount of short-term debt accumulated by the British Government during the war. Whereas, up to the introduction of Lease-Lend, Great Britain had to make cash payment to the United States for supplies received, many other countries—and above all India—supplied vast quantities of goods on credit. The proportions in which the costs of the war falling directly on India were to be shared between the British and British-Indian Governments were fixed by agreement *; but the British share had to be owed, as there were no means by which immediate payment in goods or money could be made. The result was the accumulation in London of a vast sum in 'sterling balances' standing to the credit of the Indian banks; and there appeared similar, though smaller, balances standing to the credit of other countries which supplied Great Britain with goods, largely for the use of British forces in the field. These balances had to be 'blocked' in London, both in the sense that they could not be used for buying British goods and in the sense that they could not be exchanged into other currencies, such as dollars, for use in buying goods elsewhere. At the end of the war this 'blocking' had to continue; for Great Britain was still in no position either to liquidate the sterling debts in British products or to give other currencies in exchange for them. The creditor countries, however, wanted this blocked money for the purpose of making purchases of which they stood urgently in need. For example, India badly needed to borrow capital for its own economic development. It became plain that agreements would have to be reached for funding part of these debts, with a view to paying them off by instalments over a long period of years, and at the same time for releasing some part of them, so that they could be used for making immediate purchases either in Great Britain or elsewhere.

But how was Great Britain, faced as it was with a serious deficiency in its ability to pay for necessary current imports out of the reduced

* It should, however, be remembered that the agreement was made with the *British* Government of India, which was not then an independent country.

yield of the export trades, to shoulder the additional burdens involved in paying off even a proportion of these accumulated sterling debts? One way was to borrow the required sum from the United States, on a scale big enough both to meet the current deficit on foreign trade account and to leave something over for paying off a proportion of the short-term sterling debts owing to India and other countries. But, as we shall see, when the negotiation of a loan from the United States to Great Britain was undertaken, the Americans made it an explicit condition that no part of any such loan should be applied towards the liquidation of Great Britain's sterling debts, and also that Great Britain should attempt to negotiate a settlement of these debts with its creditors. The whole question of the American Loan will be considered in a later chapter of this book, and cannot be discussed here. What is relevant at this stage is to point out that the existence of a large body of sterling debts made it not nearly enough for Great Britain to raise exports to a level high enough to pay for current imports. It was necessary, in addition, to provide a balance of exports over imports that could be used for the gradual liquidation both of the sterling debts and of any further debts that came to be owing as a result of further loans from the United States or Canada or from any other country. In face of these obligations, it was out of the question for Great Britain, for some time after the war, to have any net surplus on overseas account available for capital investment either in the British Empire or elsewhere. The first problem was to achieve a balance: the question of a surplus for real investment could not arise until that had been done.

In fact, during the years which followed the war, Great Britain did pay off by instalments a considerable part of the sterling balances that were owed to India and to certain other countries, and did also provide limited amounts of capital, by gift as well as by loans, for colonial economic development. This, however, was made possible only by borrowing from the United States and Canada, and later by the receipt of Marshall Aid from the United States. Moreover, at certain points, instead of exporting capital on balance to the colonies, Great Britain was actually borrowing from them. This happened because, after the outbreak of the Korean War, the prices of colonial raw materials, such as tin and rubber, rose to fantastic heights, and the colonies which produced these materials accumulated in sterling large receipts which they could not (or in part were not allowed to) spend at once. These sums were paid by the purchasers of the colonial materials largely in dollars; and they became

part of the British gold and dollar reserve. They were, however, still owed to the colonies, and therefore a part of this reserve needed to be kept for paying them off in future years. They did not indicate any ability, on Great Britain's part, to make additional overseas investments.

In the world of to-day there is an immense need for capital in the economically undeveloped countries; and Great Britain will have to accept the responsibility for providing some of this capital. But Great Britain's share in this is bound to be much smaller than in the past, and the main source for some time to come is bound to be the United States. The very existence of an active process of capital development in the economically backward countries may nevertheless play an important part in determining the structure of British industry and the level of saving and investment appropriate to the new conditions. It is clear that, unless large-scale foreign investment revives and thus creates a large world market for capital goods, increasingly important elements in the investment of capital in Great Britain will be in British agriculture, in what are called 'tertiary industries', and in the development of not directly economic services. The tendency for new investment to shift into these latter fields from manufacturing industry was already marked in the period between the wars, when it was increased by the depression in productive employment; and it meant that a growing proportion of total new investment was undertaken, either by public bodies directly, or by agencies acting under public influence and subject in some degree to public control. Housing and roads absorbed between them a very high proportion of the total of new capital invested; and other major enterprises, such as the construction of the electricity 'Grid' and, outside the tertiary field, the development of the London passenger transport system, were carried out in the 1930s under Acts of Parliament establishing Public Corporations for the purpose.

In face of severe pressure on the balance of payments Great Britain has had no alternative to seeking a reduction in dependence on imported foodstuffs similar to the reduction in the field of manufactured imports that was achieved after 1931. Such a policy was unavoidable, even if the cost of growing more food at home appeared to exceed the cost of buying abroad; for foreign purchases had to be kept within limits set, not by relative prices only, but also by the supplies of foreign exchange, especially dollars, made available by the preparedness of foreigners to buy British exports. The

success achieved in expanding exports largely determined how far the policy of higher home production of foodstuffs had to be pressed; it would have needed to be carried much further in the absence of loans and gifts from the United States and from Canada. This need to expand home food production made it imperative to do everything possible to raise the efficiency of British agriculture, in order to avoid putting up the British cost of living; and this involved the application of a substantial amount of capital to land development, to the renovation of farm buildings and the improvement of agricultural machine equipment, to the better breeding of livestock, and to the raising of the net output of agricultural labour. These needs continue; and herein lies an additional reason for expecting that it will be necessary to maintain home investment at a high level for a considerable number of years, and that such investment will be bound, in the main, to take precedence over any large-scale resumption of foreign lending of the traditional kinds.

If, as seems highly desirable, overseas investment proceeds in future, not as it did in the past in a quite unplanned fashion under the direction of the profit-expectations of individual entrepreneurs, but to a considerable extent in accordance with planned arrangements entered into by the Governments of the borrowing and lending countries—a method of which the British Colonial Development Acts may be regarded as forerunners and the post-war International Bank as a first experiment on a world plane—State influence over investment policy will evidently be extended further still, and the determination of the socially desirable rate of capital accumulation will come to be largely a matter for Governments and for the economic agencies acting under their auspices.* Should extensive overseas investment not develop again, it seems evident that the *optimum* rate of capital accumulation in Great Britain would be

* It should, however, be noted that there is one particular, and growingly important, form of foreign investment the control of which depends on the control exercised by the Government over large-scale private businesses. This is the investment of funds by such businesses in establishing subsidiaries abroad in order to enter markets closed or restricted by import duties or prohibitions. At present, some control is exercised over such investment as part of the general restriction on the supply of foreign exchange; but it is not too easy to regulate the investment abroad of profits earned by existing subsidiaries of British companies. Of course, such investment may be necessary; but whether it takes place or not depends, apart from the control which at present exists, not on its desirability from the standpoint of the British economy but on the prospects of profit which it offers to the companies concerned.

likely, apart from payments due on foreign debts, to be reduced in the long run to a considerably lower level than has been usual in the past, and that it would be possible, if once these debts could be got out of the way, to devote a larger proportion of the total productive resources to the satisfaction of current consumers' needs. But this view involves ignoring the practically illimitable needs of the less developed countries for investments designed to improve their productivity—a need to which no end can at present be foreseen, and one which the British people, with its relatively high standard of living, ought clearly to play its part in meeting. Even apart from this consideration, a lower proportion of productive capacity devoted to investment would not necessarily mean a decline in the activity of the industries producing capital goods; for such goods may be the most acceptable British exports to send out in exchange for necessary imports. The export of capital and the export of capital goods do not coincide, though obviously export of capital does stimulate demand for exports of capital goods. A decline in the industries producing capital goods is to be expected only if exports as a whole decline—with the necessary correlative of a sharp decline in imports. This might happen if the world, instead of working out concerted arrangements both for the exchange of goods and for the development of the backward countries, were to fall back for a considerable period into conditions of economic nationalism. Such a possibility, disastrous as it would be for Great Britain, cannot be ruled out. It might come about as the accompaniment of political nationalism or as a consequence of the breakdown of international arrangements for the regulation of foreign trade and the monetary exchanges. To these vitally important problems I shall return in a later chapter: at present I wish only to emphasize the extreme uncertainty in which we must remain about the future level of investment in relation to current consumption in Great Britain until we can form a reasonably clear notion of the course which international commercial and monetary policies are likely to follow—in the long as well as in the short run.

The general conclusion to be derived from what has been said in this chapter is that the right balance between investment and consumption depends on circumstances and varies from time to time. As the purpose of all capital accumulation, or rather the only legitimate purpose of such accumulation, is to promote an increased flow of consumers' goods and services, it follows that accumulation *now* implies a decision to expand consumption later, when the increased

supply of goods produced with the aid of the invested capital becomes available. In any one country, the increased consumption can be postponed if capital is being lent to other countries for development; but it remains true for the world as a whole that consumption must increase *somewhere*, if the investment is not to be stultified.

It also seems clear that the rate at which private individuals decide to save out of their incomes has been in the past almost wholly unco-ordinated with the rate at which investment in new capital goods has been carried on. The older economists believed that these two things would be brought into balance by the fluctuations of interest rates. But, as Keynes has shown, this is clearly not the case. Financiers of industrial development in most fields are but little influenced by interest rates in determining how much real investment to undertake; they are mainly affected by their expectations of profit, to which Keynes gave the rather misleading name of the 'marginal efficiency of capital'—a phrase which conceals the point that the determining factor is not what does happen, but what business men expect to happen. Moreover, rates of interest are subject to many other influences besides those which arise in the higgling of the capital market. The rate of investment is in effect determined by business men and by Governments, as far as the latter intervene with demands for capital, quite apart from the rate of attempted saving; and there seems to be no good reason why the rate of attempted saving should be allowed in future to settle the rate of investment rather than the other way round. Indeed, the sensible course is surely that of beginning with a programme of investment determined in the light of the public need for capital extensions, and then adapting the rate of saving to this programme by less painful means than have been practised hitherto. It is a very strange way of bringing about what Keynes has termed the necessary equality between 'savings' and 'investment', to allow the balance to be restored, whenever investment falls below attempted savings, by inflicting losses on the entire community at the risk of provoking a further dangerous recession in economic activity. And it is hardly less strange to insist that the right remedy is always that of raising investment to the level of attempted savings, without asking whether the community would be better served by saving less and consuming more. In the near future, this may not be a practically important point, on account of the high level of new capital expenditure that will continue for some time to be needed

both for reconstruction at home and for the development of the more backward countries in order to raise standards of living throughout the world. Later, it may come to be of the utmost importance for the welfare of the people.

In the Soviet Union, of course, investment policy already governs in principle the rate of attempted saving. Private savings out of income, though they exist, make only a small contribution to the total accumulation of capital, and are entirely without influence in determining its amount. The Five Year Plan for the time in force is meant to settle how much of the national productive power is to go into the making of capital goods and consumers' goods respectively, how much into production for export, and how imports are to be distributed between capital goods and consumers' goods. These are the operative decisions which settle the amount of investment; and the provision of the necessary finance is then made, through the national budget and the banking system, as a purely derivative matter. Such a system is not fully possible where private enterprise occupies the greater part of the field of production, nor does everything in the Soviet Union actually work out 'according to plan'; but an approach to it is possible, by the regulation of investment through some such body as a National Investment Board equipped with adequate positive powers and through the management of credit supplies through a Central Bank operating in accordance with general economic and financial policies laid down for it by the State.* Such a system would still leave the rate of attempted saving unregulated; but we have seen already that there are ways open to the State, by effecting a re-distribution of incomes, of operating directly on the rate of saving so as to bring it into conformity with national needs.

In the light of what has been said in this chapter it should be evident that there will be, for a considerable time to come, no likelihood of 'savings' running ahead of the *desirable* rate of investment. The danger is rather that the community, in pursuit of higher standards of living for rich and poor alike, may, in face of high

* Obviously, the mechanism established in 1946 for the control of certain forms of investment falls a very long way short of what I have here in mind. A National Investment Board, as I conceive it, would be primarily concerned, not with preventing bad investment (though this would be one of its subsidiary functions) but with promoting and itself making investments needed for the balanced execution of a national plan of production. See my discussion of the matter in *The Machinery of Socialist Planning* (1938), and, more briefly, in *The Means to Full Employment* (1943), and in *A Plan for Democratic Britain* (1939).

taxation which is used for meeting current public expenditure on arms, social services and the upkeep of government, fail to set by enough to meet the demands of economic development at home, not to mention those of the less developed countries. There is thus a serious danger of under-investment arising, not from the unwillingness of business men to take the risks of adding to productive capacity, but from the failure of income-receivers and business concerns to set by enough of their receipts to cover desirable capital outlays, or of the Government to provide the sums required for desirable capital investment under public auspices. A serious slump could still bring about a decline of investment below current 'savings'; but the major matter at present is to bring real savings, public and private, up to the level which the changed situation of the British economy and the increasing demands of the less developed countries imperatively require.

IX

THE FINANCIAL SYSTEM AND ITS WORKING

THE British banking system, as it exists to-day, is based mainly on two sets of institutions—the *Central System*, consisting of the Bank of England and the Government Exchange Equalization Fund, and the *Commercial System*, to which belong the joint stock banks which are the chief receivers of private deposits and makers of business advances. Subsidiary to these two sets of institutions are the specialized financial houses of the City—the 'merchant bankers', as they are sometimes called, the discount houses, and the bill-brokers. 'Issuing Houses', dealing in long-term capital issues, overlap largely with the merchant bankers, but include a number of other concerns as well. In addition, there are the numerous foreign and imperial banks which have offices in London, and the British banks and banking subsidiaries operating overseas. For certain purposes, it is very necessary to take account also of the great Insurance Companies and of the various types of Investment Trusts and Finance Companies; and during the present century the Building Societies have also risen to a position of importance as depositories of very large capital funds. Nor can we ignore the Stock Exchange, in which in practice dealings take place in new as well as in 'second-hand' stocks and shares. Finally, we must add the Trustee Savings Banks and the Post Office Savings Bank and—a more recent recruit of substance—the National Savings Committee.

These institutions together make up a highly complex financial system. Regulation of the currency and of the volume of short-term credit available is shared between the Bank of England and the Treasury, which directly controls the Exchange Equalization Fund. Short-term financing of home industry and the banking business of firms and of private persons of the upper and middle classes are mainly in the hands of the joint stock commercial banks, though the merchant bankers also come in to a limited extent. The financing of foreign trade is a matter for combined action by commercial banks, discount and acceptance houses, and bill-brokers, with the Bank of England coming in as a 'lender of last resort', and what is in effect a special Government bank—the Export Credits Guarantee Department. Short-term lending to the Government involves a wide range of bodies—the Bank of England, the commercial banks,

the discount houses and bill-brokers, and the London offices of the foreign and imperial banks. Longer-term financing of industry is a matter for Issuing Houses, Investment Trusts and Finance Corporations, the Stock Exchange (under the special arrangements for 'introduction' of new shares), Insurance Companies, and the special subsidiaries created by the Bank of England and the commercial banks for this purpose. There are in addition special agencies for middle-term finance, such as the United Kingdom Commercial Corporation in the realm of foreign trade and the Agricultural Mortgage Corporation. Small savings are catered for by the Trustee Savings Banks, the Post Office Savings Bank, and the National Savings Committee, and also by the Building Societies, the Co-operative Societies, and, of course, the Insurance Companies. The Investment Trusts, including the Fixed Trusts, enable the small investor to spread his risks over a number of investments of different kinds; and municipalities also offer facilities for the investment of savings in housing and other bonds. Friendly and Collecting Societies as well as Insurance Companies, offer facilities for the accumulation of small savings by way of insurance; and there are numerous Pension Funds run by business firms for their employees, while some businesses still accept loan capital from their employees.

Among these financial agencies existing for a wide variety of purposes, the key positions are held by the Bank of England, the Exchange Equalization Fund, and the commercial banks. The Bank of England, now publicly owned, occupies, as the Central Bank, the pivotal position. It is at once the Government's bank, the commercial banks' bank, and the 'lender of last resort' to the other institutions which go to make up the money market for short-term funds. As the Government's bank, it both holds deposits of government funds and is available to make short loans to the Government when they are called for. The Government does not in fact, under normal conditions, borrow much directly from the Bank. It meets its need for short-term funds mainly by the issue of Treasury Bills,* either to the 'public'—which means in fact mainly banks and other financial agencies, including foreign agencies that wish to hold resources in short-dated sterling securities—or by way of borrowing idle funds in the possession of particular departments or agencies of the State. The Bank of England, however, is there to make 'ways and means

* Or, during the 1940s, Treasury Deposit Receipts against advances made by the commercial banks. See pages 211 and 215.

advances' to the Government when they are needed. Formerly, such advances were frowned upon by the orthodox, who regarded them as having an inflationary effect. The drawing of cheques directly on the Bank by the Government does, no doubt, serve to swell the 'cash' balances of the commercial banks at the Bank of England, and does in this way enlarge the basis on which they are entitled by tradition to rear the superstructure of bank credit; whereas the issue of Treasury Bills to the public takes funds off the market. Modern opinion, however, will hardly condemn a practice merely because it enlarges the basis of credit, without inquiring whether the enlargement is desirable or not. Borrowing by the Government from the Bank of England is no different in its effects on credit from open market purchases of securities by the Bank itself. Clearly the Government, if it borrows directly from the Bank, has to take account of the effects which its borrowing will have on the volume of bank credit; and the Bank, if such borrowing has occurred, will have to take account of it in determining its own open market policy. But there is no inherent wrongness in the Government borrowing from the Bank of England, unless *all* measures by either the Government or the Central Bank which enlarge the basis of credit are to be condemned out of hand.

As the bankers' bank, the Bank of England holds the reserve deposits of the commercial banks, and transfers deposits from one bank to another in accordance with the results of the clearing of cheques between them. The Bank of England, unlike the Federal Reserve Banks in the United States, does not lend money to the commercial banks, which always keep credit balances in its hands. It can, however, as we have seen, affect the size of these balances by means of open market operations, and can thus determine the size of the 'cash' basis on which the commercial banks hold themselves free to erect a credit superstructure. By tradition, the joint stock commercial banks have had no share in the government of the Bank of England, and have not, like the merchant bankers of the City, been represented on its Court of Directors. Discussions on policy, of course, have taken place between the Bank of England and the commercial banks both before and since the former was nationalized; but there has been no interlocking of direction between them. It has been part of the traditional principles of the English banking system that the Bank of England and the commercial banks should stand apart, and that Central Banking policy should not be subject to any formal influence from the commercial banks. This traditional prin-

ciple was derived from the idea that the Central Bank should be the guardian of the national money against inflation, to which commercial bankers were supposed to be prone because they had an interest in swelling the amount of their profit-earning assets. This was probably true in the early days of the nineteenth century; but it has not been true for a long time past. The commercial banks have usually been able to earn without difficulty quite enough profit to pay high stabilized dividends to their shareholders without embarking on any venturesome policies; and beyond such dividends they have had, in modern times, no desire to go. The commercial banks are, in effect, not run nowadays for the purpose of making the largest possible profits, but rather in accordance with the notions of sound finance which those in charge of them entertain. The separation between them and the Bank of England nevertheless continued; and there was something to be said for it, as based on a distinction of functions, even if the original reasons for it had largely disappeared.

Since the Bank of England has been nationalized, the relations between it and the commercial banks have been changed in one important respect. Under the nationalization Act the Bank of England has been given powers to issue directives to the commercial banks and has thus acquired a certain control over their proceedings. This has meant in practice, not that the powers have been directly used, but that the commercial banks have been informally advised to a much greater extent than before about the monetary policies of the Treasury and the Central Bank, and have complied with the advice given them without the need for formal direction. We shall come back to this matter when we are considering how the whole system works under the new conditions.

As a 'lender of last resort', the Bank of England has been available to re-discount bills of approved quality whenever the commercial banks have suddenly withdrawn funds from the discount market and have thus left the agencies which normally carry bills on borrowed money in need of alternative accommodation. As the Bank's policy has been to reserve itself as a 'lender of last resort', it has not normally sought bill-discounting or similar business; and the rate which it has charged for re-discounting bills has usually been above the market rate. Accordingly, any substantial holding of bills by the Bank of England has been a sign of money market stringency; and when the regular bill-discounters have been driven to the Bank for accommodation they have often incurred losses, by

having to put up with a discount higher than they exacted when they bought the bills in question. Such losses have been part of their ordinary risks; and the discount rates ordinarily charged have taken account of them. They have been the price paid for an assurance that, even when the commercial banks restrict the supply of short-term credit on the money market, default need not follow; and of course the effect has been to force up the rates of discount on new bills until the stringency has disappeared.

The Bank of England has thus been the pivot on which the entire British banking system has turned. In addition to these normal and regular functions as Government's bank, bankers' bank, and 'lender of last resort' to the money market, it has assumed in more recent years certain special functions in relation to the market for long-term capital. Between the wars, there all too often arose the need for financial reconstruction of large enterprises or of whole industries which had got into difficulties. In many cases, there had been very unwise flotations of loan capital at high rates of interest during the short-lived boom after the first World War, and in many others (or indeed often in the same) there had been excessive borrowing of short-term advances from the commercial banks to replace or supplement working capital. It often occurred that, in the course of speculative reflotations of businesses, the new companies took over only the physical plant of the old concerns, the working capital needed to finance the turnover of goods being retained by the vendors, so that the new companies, having paid a high price for the plant, found themselves without working capital for carrying on business and had to resort to excessive borrowing from the banks. When the slump came, they were unable to repay these loans, and were in many cases under the necessity of borrowing yet more in order to remain in operation. The commercial banks, fearful of losing what they had already advanced and of starting a widening circle of bankruptcies if their debtors were forced out of business, often continued to lend, but tried to safeguard their own position by registering debentures against the borrowers to cover previous loans. This meant that they ranked as prior creditors, with a first claim on the entire assets in the event of default; and the existence of such debenture claims made it impracticable for the businesses thus charged to raise fresh money on the capital market. Anyone supplying fresh capital knew that his claims would rank after those of the debenture-holders; and no one was willing to lend money or invest in share-capital on such unfavourable terms.

This was where the Bank of England, acting usually in conjunction with the commercial banks concerned, had often to step in between the wars with an attempt to straighten matters out. Arrangements were made whereby the share-capital of firms thus affected was drastically scaled down—the shareholders thus accepting the loss of a good deal of their money.* At the same time the commercial banks agreed to modify their claims, so as to facilitate the financial reconstruction of the firms affected. This resulted in the banks becoming considerable owners of industrial share-capital as well as of bonds and debentures; and the commercial banks formed a special body—the Bankers' Industrial Development Company—to assist with the provision of new capital for reconstructed enterprises. Side by side with this, the Bank of England created the Securities Management Trust, as a subsidiary of its own, to co-operate in the provision of new capital on similar lines; and, both through this body and directly, the Bank of England began to play a substantial part in the supply of long-term capital for businesses and industries clearly in need of reconstruction in order either to set their financial houses in order or to carry through schemes of development and rationalization.

Among the bodies helped in this way were the Lancashire Cotton Corporation, formed with the purpose of buying up spinning-firms and either scrapping or reconstructing them; Shipbuilders' Security Ltd., the shipbuilders' combine formed, all too successfully, with the object of buying up and dismantling 'redundant' shipyards; Richard Thomas and Co., the great steel and tinplate firm, in connection with their purchase of the derelict steel-works at Ebbw Vale in order to build there a huge modern strip mill for the supply of steel to the tinplate trade; a number of other iron and steel concerns connected with the Iron and Steel Federation; and other bodies set up in connection with attempts at reconstruction in the metal and textile trades. In these and other ways the Bank of England, hitherto aloof from the long-term capital market for home investment, came to take to itself an additional function of acting, wholly or in part, as financial sponsor of industrial projects designed

* Sometimes this was really a paper loss; for many bonus shares had been issued to shareholders during the boom, and sometimes the writing down meant only bringing down an inflated total of share capital to something like the sum actually invested by the shareholders. But, of course, where investors had bought the shares at inflated prices, the loss was real to them, even if their holdings had never represented equivalent real investment in capital goods.

to straighten out the financial tangles in which a large section of big business had become involved after the first World War.

Concern with the long-term capital market was not a new thing for the Bank of England. As the guardian of the exchanges it had for a long time interested itself in the investment of long-term capital overseas, encouraging some loans and imposing what was practically a boycott on others, mainly in relation to the balance of payments, but also from time to time on political or semi-political grounds, (e.g. in the case of Chinese loans in the period before 1914). Up to 1914, as we have seen, the great London merchant bankers, in their capacity as 'issuing houses' for long-term loans, had been concerned mainly with overseas investments; and the connections between the Bank of England and the merchant bankers were traditionally very close, the Directors of the Bank being recruited, until after the first World War, almost exclusively from the merchant banking houses. After 1918, and still more after the slump of 1931, the centre of interest shifted largely from overseas to home investment, and the merchant bankers came to play a larger part in the flotation of home issues. The Bank of England's interest also shifted; and from concerning itself with long-term overseas capital issues mainly from the standpoint of their direct effects on the balance of payments it came to concern itself also with home issues, particularly from the standpoint of rebuilding export capacity. One accompaniment of this shift in interest was a less exclusive connection of the Bank of England with the merchant bankers and the admission to its Court of Directors of persons associated primarily with home industry and commerce. In effect the Bank, in addition to its older responsibilities for the management of the currency and for the supply of funds to the money market as a 'lender of last resort', began to take on a somewhat vague responsibility for the supply of long-term capital, not to the general run of businesses, but in special cases in which the national interest seemed to be plainly involved.

This development necessarily brought the Bank of England into a new relation to the Government of the day. The Government, whatever its political complexion, was naturally anxious both to stimulate exports and to bring about a financial and technical reconstruction of industries which had got into a mess; and accordingly it was often a matter of concern to the Government whether the Bank would or would not be prepared to supply capital for schemes of business reorganization. The relations between the Bank and the Treasury had always been close, not only in matters affecting the

currency, but also in respect of the timing of operations in the capital market, so as to avoid clashing demands for loans from the Government and from private issuers.* But between the wars the relations became much closer as the Bank began to interest itself in new capital issues at home. The Government could not, without raising howls about nationalization, itself subscribe capital for the reorganization of privately owned industries; but it could incite the Bank to do this for schemes which it—the Government—approved and desired to foster. To an extent that cannot possibly be determined, the Bank of England, in providing funds for such projects as the Lancashire Cotton Corporation and Richard Thomas's strip mill at Ebbw Vale, was acting as the independent agent of the Treasury and of the Government as a whole. The Bank, and not the Government, found the money for these schemes; but in effect the Government and the Bank were acting together, in pursuance of a mutually agreed policy. The Government could not then coerce the Bank into investing where it did not want to; but the Government could influence the Bank, and the Bank the Government, in selecting projects which were to be regarded as worthy of help.

This form of Central Bank action, in close consultation with the Government of the day, was no doubt prompted largely by the desire to keep the Government out of business and to ensure that the reconstruction of enterprises and industries that were in difficulties should be carried through under business, and not under official, auspices. It was a way of getting what was in effect public help without submitting to the sequel of public control. True, in certain cases, for example that of Ebbw Vale, the recipients of the help found the control conferred on the Bank as irksome as control by the Government could well have been, but such instances were exceptional. In general, the Bank of England managed its control on such lines that the recipients were satisfied—the more so because they could resume independence when and if they found themselves able to pay off the Bank's loans, and the position of 'private enterprise' was thus safeguarded against forms of state control which could not, perhaps, have been so easily shaken off.

So far, I have spoken of the Bank as it was while it remained a private corporation, responsible to the State only for the manage-

* 'Private issuers' must here be understood as including local authorities, over whose discretion to borrow in the capital market an increasing control came to be applied. Government loans must be taken as including 'conversion' loans, designed to re-fund maturing debts at the lowest practicable rates.

ment of the currency in accordance with its Charter, and in other respects legally free to pursue a policy settled by itself. In practice, the relations between the Bank and the Treasury were all along very much closer than its Charter formally prescribed; but up to 1946 it was always permissible to wonder whether, in the final resort, the Bank controlled the Treasury, or the Treasury the Bank. The transference of the ownership of the Bank's capital to the State, and the new provision whereby the Government appoints its Governor and Court, have made it clear that, for the future, the Bank is intended to serve as an instrument of public policy, and that, in any future emergency, the last word will rest with the Cabinet rather than with the Bank. Beyond this important difference, the transfer of the Bank of England to public ownership does not seem to have had any great effect on its functions or on its day-to-day working. The Governor and Court of Directors, though appointed by the Government, have been left with a large measure of autonomy: so that, in practice, the relations between the Bank and the Treasury have not been much different from what they were in the past. It is, indeed, a new feature that the publicly owned Bank of England has been given certain formal powers of requiring information from the commercial banks, and even of controlling their operations; but in practice these powers have not gone much beyond what the Bank of England was actually doing, in an informal way, before the Act of 1946 was thought of. In effect, nationalization of the Bank of England, important as it may prove to be in the future, if and when extensive measures of national economic planning and development on Socialist lines come to be undertaken, has so far made little difference to the everyday working of the financial system. The big change in the Bank's position in the monetary system took place, not when it was nationalized, but when the establishment of the Exchange Equalization Fund took the control of the foreign exchanges out of its hands—a change which was completed when, in 1939, the residue of the Bank's gold holdings was transferred to the Fund.

Let us turn now from the Bank of England to the Exchange Equalization Fund, which, as we have seen, is under the Treasury, but is operated under the Treasury's orders by the Bank of England. The E.E.F. was established in 1932, with the purpose of guarding the foreign exchanges against influences, mainly speculative, which might have led to large short-term fluctuations in the external value of sterling, now that it was no longer pegged to gold. The E.E.F.

was financed by government borrowing in London, in the form of Treasury Bills. It could thus acquire a supply of sterling which it could use in buying either gold or foreign money. At a time when there were large inflows of foreign funds to London, including considerable imports of gold, the E.E.F. could buy up these foreign funds and thus equip itself with resources which it could use later if there should arise a demand to change sterling into foreign money beyond that which could be met out of the current supplies of such money reaching London in payment for visible or invisible exports. In practice, though the E.E.F. bought considerable supplies of foreign currencies when occasion served, it came to hold considerable stocks of gold against foreign deposits in sterling.* This gold could be readily converted at need into dollars or into any other currency required: its only disadvantage was that it was a non-earning asset. It came in very handy during the earlier stages of the second World War for buying essential imports that had to be paid for in hard cash.

A Fund of this kind, having only limited resources, can influence the relative values of home and foreign monies only within limits. If, for example, there is a persistent tendency for the demand for foreign currencies to exceed the supply coming in, an Exchange Equalization Fund cannot stand out indefinitely against such a tendency; for in the long run it must run out of gold and foreign money, and be left with only sterling in its possession. Its capacity to stand out against a reverse movement is greater; for if it runs out of sterling it can always borrow more in the home money market, provided it is given the requisite authority. It is not, however, the purpose of such Funds to resist persistent forces making for an alteration in the rates of exchange. The purposes to be served are, rather, to neutralize short-term tendencies towards exchange fluctuations which are deemed not to correspond to long-term trends. Thus, if foreigners, on account of a feeling of insecurity in their own countries, take to moving liquid funds into Great Britain, the Exchange Equalization Fund can acquire these funds and turn the whole or a part of them into gold or dollars, which it can then hold in readiness to be paid out in case the owners decide again to take their money away. In the meantime the Fund can, by sterilizing these holdings, prevent the influx of foreign money from inflating the cash basis on which the British structure of credit is raised. To do this, of course, involves the forgoing of earnings of interest on the sums thus sterilized; but this may be a small price

* For the actual amounts held in gold and foreign exchange see page 75.

to pay for preventing the monetary disturbance which the influx and efflux of the foreign funds might otherwise have caused.

Secondly, by holding a large fund of manœuvre, those who are responsible for managing the Fund can make conditions difficult for speculators in currency. In the absence of the Fund, speculators could, by speculating on the appreciation or depreciation of a currency, largely make their own predictions come true; for if they bought in anticipation of a rise in its value, their purchases caused it to rise, and if they sold in anticipation of a fall, their sales caused it to fall. If, however, the Fund could enter the market at any moment either to buy or to sell, it could easily defeat the speculators' anticipations, and profit at their expense if they persisted. It was, in fact, found possible to operate the E.E.F. at a profit, despite the loss of interest that had to be incurred when it sterilized funds for fear of undue monetary expansion.

Thirdly, the Fund can offset short-term fluctuations due to such factors as seasonal changes in the supply and demand relations between particular currencies. There used always to be a period in the autumn when the demand for dollars in London tended to exceed the supply, because large payments had to be made for American crops imported into Great Britain or other countries closely related to the 'sterling group'. With the aid of the Fund, such seasonal, fluctuations can be ironed out, by letting the Fund's holdings of dollars run down for the time, and thereafter replenishing them as the conditions made this possible.

The British Exchange Equalization Fund was the first in the field, though the technique of it was largely based on the experience of Central Banks in other countries which had held an appreciable part of their reserves not in gold but in foreign exchange (e.g. sterling in the case of Commonwealth countries). The British example was soon followed by the setting up of similar Funds elsewhere; and it then became necessary for those in charge of these Funds to act and consult closely together, for fear of acting one against another. The consequence was that between the group of countries operating such Funds—and especially between Great Britain and the United States—their management became increasingly a matter of concerted international policy. It was necessary for the various countries to agree broadly upon the relative valuations of the various currencies which they would endeavour to support; and, to the extent to which they did act together, a new international standard, much more flexible than the gold standard, was

in process of being set up. There were no fixed parities; but there was in embryo a system of international management of relative currency values which removed them out of the purely domestic sphere. A country belonging to the group could no longer alter the relative value of its currency quite at will: it had to consult the others and, though the final decision remained in its hands, it could act only in the knowledge of how its action would be received by the rest.

This half-international arrangement was gradually establishing itself during the years before the second World War. It was hardly more possible, however, for the group as a whole than for a single country to stand out against a really persistent tendency for the value of one currency in terms of the others either to rise or to fall owing to real lack of balance in the supply and demand at the existing level. Exchange Equalization Funds showed themselves exceedingly powerful in reducing temporary fluctuations, in checking currency speculation, and, one may add, in deterring countries from deliberately depreciating their currencies in the hope of expanding their exports. But the new device was no way of creating exchange stability in face of persistent real forces calling for a change in relative currency values.*

We can turn now to the position of the joint stock commercial banks. These, as we have seen, are primarily bankers for the business world and for the private accounts of the wealthy and middle classes. As loan agencies, they provide the bulk of the short-term working capital needed by industry and internal trade over and above what is provided directly out of long-term business capital. They are also among the main suppliers of short-term funds to the money market for discounting bills and to some extent for stock exchange specula-

* I have phrased this account of exchange equalization mainly in the past tense because, whatever may emerge in the long run as the new method of regulating currency relations, the future arrangements will clearly differ greatly from those which came into existence between the two World Wars. Whether, in the long run, the arrangements entered into at Bretton Woods and the international decisions based upon them will turn out to provide a workable basis for future currency management, or will break down and have to be replaced by more elastic provisions taking fuller account of national differences or of group arrangements between particular countries, whatever does emerge is likely to be radically different from what existed in 1939. It is therefore most convenient to leave all consideration of the present transitional conditions over for discussion in the later chapter in which we shall be considering the Bretton Woods Agreements and other post-war arrangements such as the European Payments Union.

tion; and they are themselves large buyers of both Treasury Bills (as well as of longer-term Government securities) and of trade bills, especially those with only a short time to run before maturity. They also perform numerous other services for their customers, including trustee business and the purchase of investments; and through special subsidiaries they conduct a considerable amount of banking business abroad.

We have seen that, in respect of loans and advances, the commercial banks are creators of credit, but that their power to create it is limited by convention to what the Central Bank allows them to create. They can thus be regarded as primarily distributors of credit up to a maximum settled by Central Bank policy. Clearly, they are in a position to influence the course of economic affairs very greatly, both by their action in lending, or not lending, up to the maximum allowed by the Central Bank—a problem which has been discussed in a previous chapter—and by their selection of the particular enterprises to which they are prepared to make loans, and by the amount of credit they are ready to advance to any particular applicant.

In general, British commercial bankers say that they do not place their loans with any desire to discriminate between applicants except in respect of their 'credit-worthiness', in the sense of their ability to meet their obligations. They disclaim any responsibility for influencing the course of economic policy, or for interesting themselves in controlling the affairs of the trades and industries to which they advance money. Economic policy, they say, is ordinarily none of their business, though they cannot help interesting themselves when those to whom they have advanced money get into difficulties. As debenture-holders, they may have sometimes to put in receivers to manage particular firms on behalf of the creditors; and they may have to impose conditions when firms already deep in their debt come to them with proposals for funding their indebtedness, or with requests to borrow more money in order to carry on. But such happenings, numerous as they have been, are still often regarded as out of the ordinary run; and in general the commercial bankers' view of their functions is that it is none of their business to interfere with their debtors when all is going well.

In many other countries, the position is a good deal different from this. Either the ordinary commercial banks normally expect to have a good deal to do with the affairs of their business customers, in whose enterprises they often hold shares, or there are numerous

industrial banks which specialize in various forms of industrial finance, and are to a substantial extent providers of long-term and middle-term capital, as well as of short-term credit. In this country, the agencies which have carried on this sort of activity have been for the most part not the ordinary commercial banks, but specialized financial institutions not engaged in deposit banking of the ordinary type. We shall come to them later; our present concern is with the joint stock commercial banks only.

These banks, even if their controllers are quite sincere in disclaiming any intention of interference or of attempting to influence economic policy, cannot in fact help doing this to a very considerable extent. It was unavoidable between the wars that they should greatly influence the fortunes of industries which had run into financial difficulties; for they had to choose when to give and when to refuse further accommodation to help struggling firms to carry on, and what conditions to attach to any assistance they were prepared to offer. It was often a bank, or a group of banks, that decided whether certain firms were to be forced to close down or to amalgamate, or whether a particular firm was to be forced to join, and submit itself to the discipline of, a trade association or ring which existed in its branch of production or trade. It was, again, often the banks that decided whether, and on what scale, money was to be made available for the modernization of this or that industry or business, or whether a firm or group was to be allowed to embark on a new, credit-requiring experiment of launching out on fresh lines, or opening up a new market.

In exercising such influence there was an almost unavoidable tendency to help the big firm or combine more readily than the small business, both because the former had the more influential backers, who, if displeased in one field, might retaliate to the bank's disadvantage or discomfort in another, and also because the bigger the business, the likelier it was either to be able to provide good security or, if it could not, to hold out the danger that its collapse would involve others. The big man was at a sure advantage in looking for credit, except as far as special agencies were provided to look after the requirements of the smaller concerns. Very often, the small man's credit-worthiness rests mainly on his personal qualities of skill and enterprise, and he cannot offer collateral security; and it seems past question that the disappearance of the old localized banks and their absorption into a nationally controlled system diminished the readiness to go by the test of personal quality in deciding to whom

to lend. True, the bankers have habitually asserted that they have done their best to offset this tendency by placing considerable discretion in the hands of their more trusted local managers; but the extent of this discretion has in fact varied a good deal from bank to bank, and, of the Big Five, only Barclays seems to have had anything in the nature of a regular system of regional devolution.

It is, moreover, a fact that the small man's account is often a great deal more trouble to manage than the big man's, in respect of the amount of work falling on the bank; and this is sometimes advanced as a reason for charging the small man more in total (including other bank charges as well as interest) than the bigger borrower. Besides, though in theory the banks used to have a system of uniform loan rates, this was often departed from in the case of really large loans; and in the period between the wars even such uniformity as there had previously been showed an increasing tendency to break down.

I do not think anyone can honestly deny that the really big concerns have usually been able to get the best terms for themselves from the banks, or that the small man has been at some disadvantage. It would be most surprising if this had not been the case, in an economic system mainly dominated by big business and, on the financial side, largely run by men whose interests are not limited to a single concern or line of production, but ramify through many businesses, so that the banker knows them as financiers whom he meets at every turn. It is an old saying that it is much easier to borrow a million than a hundred pounds; and in this context its truth is plain.

It must not, of course, be left out of account that businesses, both large and small, differ greatly in their demands on bank accommodation. Some businesses have, in addition to their assets locked up as fixed capital in buildings, plant, land, and other permanent equipment, large funds which are available as working capital to finance their operations—that is, to pay wages, to meet the cost of materials, and to grant trade credits to cover the period of business turnover. Such firms may, despite their possession of this capital, be large borrowers from the banks; for they may prefer to invest their capital at long term and receive interest on it, and to borrow at short term from the banks, if necessary depositing their securities as collateral. A quite large fraction of the National Debt is normally held in this way by business firms, which can often get on their investments a higher return than they have to pay to the banks for

overdrafts or loans—especially as their investments earn interest all the time, whereas they have to pay interest to the bank only for the actual periods for which they need the money. When, however, bank charges for interest are high, it may pay firms to sell out their securities and provide their own working capital instead of applying to the banks. When this happens, the banks find the demand for credit falling off, and are driven to invest in the securities which the business firms are selling. Bank holdings of securities rise, and loans and overdrafts fall off; firms' holdings of securities fall, and they finance more of their turnover out of their own working capital. Such changes may occur without any accompanying change in the volume of business activity.

Other firms, however, have no such reserves of working capital which they can call upon at will to finance their period of turnover. Either their capital is all locked up in their own plant and equipment, or, if they have outside investments, these are not liquid, so that they cannot be sold and bought back as changing relations between long-term interest rates and bankers' rates for advances make such transactions expedient. Their holdings may be in other businesses with which they desire to maintain their connections, or may be such as they can dispose of only at a loss they are not prepared to face. In such cases, or where they have no considerable outside holdings, they must rely on the banks for working capital whatever the banks' current rates of interest on advances may be. Many of the smaller businesses, and especially rising businesses which are expanding from small beginnings, are apt to be in this position, and to depend at all times on the advances they can get from the banks.

Since 1945 the situation has been considerably different from that which existed between the wars. There has been, in general, a condition of full employment; and the British economy has been at strain in its endeavour to meet the need for greatly increased exports as well as to supply the home market. Many materials have been scarce on account of the restrictions that have had to be put on imports or of shortage of productive capacity (e.g. coal and steel); and it has been a definite part of government policy to promote the highest possible production. In these circumstances, it has been recognized as indispensable for the Bank of England to provide enough credit facilities to enable the commercial banks to meet all demands for credit coming from firms whose output is regarded as necessary either for export or for meeting home requirements. This

does not mean that bank advances have been available without limit to any firm which has chosen to ask for them: it does mean, broadly speaking, that no firm has been unable to get credit to finance production which has been regarded as desirable in the public interest. Many firms have been required to export a high proportion of their output, and have been regarded as credit-worthy if they have complied with such demands, but not otherwise. The restriction on their freedom to do as they please has, however, often taken the form of a denial of supplies of materials, or of permits to extend factories, or of labour, rather than directly of bank credit. At least this was largely the case for some years after the war; but thereafter, as controls were given up or relaxed, and most materials became less scarce, the factor of credit supply came to be of more direct importance, especially after the crisis which followed the price-inflation of 1951. Bank credit was then to some extent restricted in order to keep inflationary tendencies in check; but it remained true that firms had usually no difficulty in getting all the advances they needed for financing production—especially production for export—which the Government wished to see undertaken.

There has indeed been a great change since 1939 in the position of the commercial banks in relation to production. As we saw, up to 1939 it was not the practice of the Government to borrow directly from the commercial banks by way of ordinary advances: nor did these banks ordinarily buy new Treasury Bills, though they did discount such bills when they were nearing maturity, and did buy government bonds, especially those of relatively short date, to hold among their securities. During the war, the Treasury began the practice of borrowing directly from the commercial banks by means of Treasury Deposit Receipts—which meant in effect that the commercial banks created money to be spent by the Government and repaid and re-borrowed in much the same way as Treasury Bills. The holding of large sums in Treasury Deposit Receipts by the commercial banks made these banks direct short-term creditors of the State. In order to be able to make the loans, they had to be supplied with the means by the Bank of England, which had therefore to enlarge their cash basis by putting them in funds—which it could do by increasing its own holding of securities.

After the war, the Treasury Deposit Receipts were gradually replaced by Treasury Bills or by advances made by public departments out of funds at their disposal; and the pre-war position was

thus partly restored, but on the basis of a greatly enlarged issue of Treasury Bills. The following figures illustrate the change:—

TABLE XII

THE BRITISH GOVERNMENT'S FLOATING DEBT, 1935-1953

£ millions End of Year	Treasury Bills	Treasury Deposits	Advances by		Total
			Bank of England	Public Depts.	
1935	866	—	37	33	936
1936	766	—	57	28	851
1937	890	—	56	39	985
1938	986	—	5	46	1,037
*1946	4,587	1,709	5	397	6,698
*1947	4,827	1,380	2	319	6,528
1948	4,579	1,511	—	265	6,355
1949	4,983	872	—	292	6,147
1950	5,168	525	—	384	6,077
1951	4,793	119	6	252	5,170
1952	4,715	—	7	252	4,974
1953	4,853	—	—	250	5,103

* December averages.

The commercial banks thus regained their pre-war position, inasmuch as they ceased to make direct advances to the Government; but it remained necessary for them to supply finance to the Government by means of Treasury Bills and holdings of short-dated securities. They were much more closely connected with the financing of government operations than before the war; and they were also expected to a greatly increased extent to carry on their business of lending to industry and trade in accordance with government-approved economic policies. They had, in effect, lost a good deal of their independence; but this had come about, not mainly through any change in their legal status,* but as a con-

* As we have seen, the Bank of England Act of 1946 did, however, empower the Bank of England to issue instructions to the commercial banks concerning their credit policy, and did thus provide in the last resort for their control by the State. But this power was not used save in the form of advice from the Bank of England.

sequence of the increases both in the size of the floating debt and, still more, in government control over the productive system. This latter increase was due not so much to the spread of public ownership of industries as to the sheer necessity of controlling production and trade in order to keep the balance of payments as favourable as was possible under the changed conditions of the British economy.

What has been said so far refers to the commercial banks mainly as suppliers of credit by way of loans and overdrafts to business firms. In the very short-term market, as we have seen, these banks are suppliers of a considerable part of the funds with which discount houses and bill-brokers carry on their operations. In this field, however, the English joint stock banks do not stand alone. A further source of such funds is found in the Dominion, Colonial, and Foreign Banks which have offices in London. These banks have often large funds on their hands for which they need an outlet that will not lock them up for long. These funds arise out of the trade—imports and exports—of the countries in which these banks carry on their main business, as well as out of the capital operations of those countries. If, for example, Australia is selling to British buyers goods to a value beyond what is being bought in Great Britain for import into Australia, funds will accumulate in London to the credit of Australian firms or of Australian Governments. These funds may be needed in due course to pay dividends and interest to British owners of Australian shares and bonds; but even so there will be times of year when money is being piled up in readiness for dividend day, and in the meantime the Australian banks in London will want to earn some interest on it. They will therefore either themselves discount trade bills or Treasury Bills, or will be prepared to lend money at call or short notice to the discount market. If they have more funds than are needed for paying for imports and meeting dividend and interest charges as they fall due, there will be a wider choice open to them, and some of the money will go into longer-term securities bearing a higher rate of interest. But among all the Dominion, Colonial, and Foreign Banks in London there will be at all times substantial amounts of money available for short-term borrowing; and this money will be lent out in pretty much the same way as similar funds are handled by the English commercial banks.

We have seen already that this short-term money is a highly unstable factor, because a contraction in the volume of loans of this type is the first step taken by the commercial banks to meet a tightening of credit conditions. Hence, as we have seen, the im-

portance of the Bank of England as a 'lender of last resort', ready to replace, at a higher rate, funds withdrawn by the commercial banks. The Bank of England, however, will not make advances on bills of all types; and in particular it will not handle trade bills unless they bear two recognized names and conform to certain standard conditions. There are always in existence considerable numbers of bills which are not eligible for re-discount at the Bank of England; and the discount house or bill-broker must, in face of monetary stringency, continue to hold such bills unless someone else is willing to buy them.

It is to be observed that, whereas foreign trade is commonly financed by bills, trade between firms in Great Britain is nowadays very seldom financed in this way. It used to be, before the growth of nation-wide joint stock banks; but bank loans and overdrafts have replaced bills as the method of financing internal trade. This is a curious fact, when one bears in mind that the rates of interest charged for bank advances are usually a long way above the discount rates prevailing for ordinary trade bills, so that it would appear as if firms could achieve considerable economies by borrowing in the latter way. In fact, some do, but only a few of the largest (including a very few municipal bodies, which have found such borrowing cheaper than bank accommodation). But the practice is naturally frowned upon by the commercial banks, which would lose their most profitable outlet for credit if it were to spread; and the difficulty of re-discounting such bills either with the commercial banks or with the Bank of England stands formidably in the way of their extended use.

As for Treasury Bills, the bill market has absorbed more and more of them of late years, especially when the level of international trade has been low, and since a larger share in the financing of such trade has been taken by United States financiers. The Treasury Bill has ousted the trade bill from its former position of undisputed primacy, which was based not only on Great Britain's high volume of foreign trade but also on the financing through London of a considerable part of the trade of other countries one with another. The great increase in Treasury Bills arises not only from the fact that the National Debt has been immensely increased by wars, but also from the holding in short-term form of a very much larger proportion than would have been approved by orthodox financiers of a generation ago. A large 'floating' (i.e. short-term, unfunded) debt used to be regarded as a sure sign of unsound finance. It has,

however, the manifest advantage that the nation pays much less for money borrowed at short term than for its funded, long-term obligations: so that the taxpayers' burden is lessened by the increase in Treasury Bills as against longer-term debt. Nor is there any counterbalancing disadvantage, provided that there remain in the market enough short-term funds to meet the demands of trade, and provided further that the Government is only replacing longer-term by short-term borrowing, and is not increasing its total debt so as to create an inflationary situation.

It has, of course, to be borne in mind that in times of depression a large supply of short-term funds may be to a considerable extent the correlative of an unwillingness to lock up money at long term, or, in other words, of a reluctance to invest in capital goods. The ease with which the State was able before 1939 to borrow at low rates by means of Treasury Bills was in part the result of a low level of investment and employment; and conditions of full employment, by creating an active demand for short-term credit as well as for long-term funds for business investment, are bound to alter the conditions of government borrowing. If, under such circumstances, the Government determines to keep the rates of interest low, it must either risk creating an inflationary situation by making short-term funds plentiful enough to meet both public and private demands, or it must ration (or cause the commercial banks to ration) private borrowers in such a way as to choke off the demands which it regards as less urgent, or as inconsistent with the best use of limited productive resources. In effect, it must either control commercial bank lending or in some other way damp down the private demand for loans; and if it is not prepared to do one or other of these things, it must allow interest rates to rise and pay interest at whatever rates the total demand for credit (including its own demands) requires.

There is, no doubt, another alternative—that of forced loans to the State at lower rates than are charged to private borrowers. This was, in effect, what occurred when, during and immediately after the war, the Government borrowed directly from the commercial banks in the form of Treasury Deposit Receipts. As we saw, these Treasury Deposit Receipts represented government borrowing direct from the commercial banks, outside the regular offers of Treasury Bills to the money market. They were direct creations of credit in favour of the Government by the commercial banks, at lower interest rates than were charged to private customers for

ordinary loans or overdrafts. Their introduction carried with it in practice a large measure of government control over the commercial banks, and their gradual discontinuance was closely bound up with the abandonment of this control and with the return to competitive borrowing by the Government at higher rates of interest.

It is necessary, at this point, to add only a few words about the more specialized agencies which, with the Bank of England and the joint stock commercial banks, make up the complex of the banking system. The 'merchant bankers' are private banking houses which, while they do some ordinary deposit banking on behalf of their very select clients, are mainly engaged in the business of accepting bills,* acting as agents for foreign Governments, municipalities, and big business houses, issuing and managing long-term loans, especially for overseas, and conducting highly specialized financing operations for a limited range of firms. Side by side with them are other 'issuing houses', mostly concerned with home issues, and ranging from large concerns which have been responsible for a considerable number of capital issues over a period of years, to houses which have but a single issue to their name, and appear to have been brought into existence solely to sponsor that issue. In between these extremes are houses which specialize in a particular type of loan, or are subsidiaries of a particular group of financiers. These, in turn, run into Finance Corporations which are in effect holding companies looking for outlets for business for concerns supplying capital goods, or materials, or land; and these are, at the margin, sometimes difficult to distinguish from Investment Corporations formed ostensibly for the purposes of enabling the investor the more easily to spread his risks over a number of concerns. Next in order stand Investment Trusts, definitely designed for such 'spreading', and having, when they are run on approved lines, a set principle of never distributing as dividends sums accruing from profitable sales of investments, but always treating such windfalls as additions to their capital resources, available as reserves against possible depreciation of investments. Distinct from these again are 'Fixed' and 'Unit' Trusts, in which the investment consists of a fixed bundle of mixed securities, so made up that they are not likely all to be subject to the same economic influences, and are thus likely to yield a more regular global return than any single security bearing a variable dividend, and also to be more stable in total capital value. The

* See page 195.

difference between the ordinary Investment Trust and the Fixed Trust is that, whereas in the former the responsible directors are expected to shift the holdings so as to get the best possible results in terms of both income and capital value, in the latter the holding is fixed permanently, and when once the trust has been started there is nothing for the managing authority to do beyond distributing the dividends as they come in. Nevertheless, some of these Fixed Trusts carry high management charges; and in the ordinary Investment Trusts also it is necessary to watch carefully not only the policy of the directors in placing the investments, but also the magnitude of management charges. The well-managed Investment Trust or Fixed Trust can undoubtedly help the small investor to secure a larger return on his money than he could get elsewhere for the same degree of risk. But such agencies are open to abuse; and it is necessary for the investor to be wary in choosing those which are well and honestly managed.

One aspect of the growth of these and other types of collective investment agency, designed mainly to meet the requirements of the smaller investors, is that they provide means of bringing the pressure of criticism to bear upon companies which would otherwise be able safely to ignore the claims of their small shareholders. The small shareholder has, under the conditions of to-day, practically no control over the use made of his money by the companies to which he entrusts it. He has, in order to reduce his risks, to spread his money among a number of concerns; and, having no means of contact with other small investors and, in any case, no real knowledge of what ought to be done, he is as a rule a merely passive acceptor of such policies as the company directors choose to pursue, and is wholly without influence in choosing the directors who are supposed to represent his interests.

Investment Trusts and similar agencies are in a position, when those who administer them think that a concern is being mismanaged, to take the question up much more effectively than any small shareholder. They can insist upon, and get representatives elected to, shareholders' committees of investigation, and can make such bodies much more effective agencies of criticism than they would otherwise be. The small investor himself remains as helpless as ever in face of the scale of modern company organization; but he gets at all events more chance of there being someone to stand up against sheer incompetence or dishonesty in the uses to which his money is put.

TABLE XIII

Joint Stock Companies in Great Britain, 1914–1952

	Public		*Private*		*Total (U.K.)*		*Companies newly Registered*	
	Number Thousands	*Paid-up Capital £ Mn.*	*Number Thousands*	*Paid-up Capital £ Mn.*	*Number Thousands*	*Capital £ Mn.*	*Number Thousands*	*Nominal Capital £ Mn.*
1914	—	—	—	—	64·7	2,532	7·4 (1913)	157 (1913)
1924	—	—	—	—	92·2	4,405	8·5	124
1926	16·2	3,180	81·3	1,456	99·0	4,686	8·4	215
1929	16·9	3,698	91·5	1,502	110·1	5,250	9·2	241
1930	16·3	3,894	95·6	1,591	113·3	5,534	8·9	113
1931	15·6	3,897	98·7	1,618	115·8	5,564	8·9	65
1932	15·2	3,880	103·7	1,657	120·5	5,586	10·7	74
1933	15·0	3,871	109·3	1,692	125·9	5,610	12·0	100
1934	14·9	3,851	115·6	1,697	132·1	5,595	13·1	148
1935	14·7	3,939	122·7	1,706	139·0	5,693	13·8	144
1936	14·7	3,993	130·8	1,742	147·2	5,783	14·5	165
1937	14·7	4,067	137·5	1,829	153·9	5,940	13·4	121
1938	14·4	4,097	143·2	1,894	159·3	6,036	13·4	76
1939	13·9	4,117	146·7	1,923	—	—	11·2	59
1940	13·7	4,113	149·8	1,961	—	—	6·5	28
1941	13·6	4,105	155·0	1,948	—	—	7·4	26

1942	13·6	4,088	161·0	1,955	—	—	6·9	26
1943	13·5	4,078	165·2	1,946	—	—	7·0	25
1944	13·4	4,052	171·2	1,935	—	—	8·1	37
1945	13·3	4,044	180·7	1,929	—	—	11·1	92
1946	13·3	4,078	202·8	1,923	—	—	25·5	136
1947	13·3	4,131	221·0	2,001	—	—	22·0	198
1948	13·0	3,906	228·1	2,071	—	—	16·5	120
1949	12·2	3,876	234·2	2,126	—	—	14·6	84
1950	12·0	3,921	238·2	2,233	—	—	14·0	76
1951	11·9	3,917	247·2	2,305	—	—	13·7	97
1952	11·7	3,995	254·0	2,369	—	—	12·4	53

The bodies discussed in the preceding paragraphs are concerned with long-term investments, and have little to do directly with banking or with markets for short-term funds. It was, however, necessary to mention them in passing because they form an essential link in the chain of financial institutions, and because Fixed Trusts especially are often subsidiary to other bodies engaged in money market operations. For the same reason, this chapter would be incomplete if no reference were made to the Stock Exchange itself and to the smaller stock markets which exist in most of the larger provincial towns. The primary function of stock exchanges is to provide a ready market for *second-hand* securities, as distinct from new issues of capital. But in practice they also deal increasingly in securities which are new as far as the public is concerned. New

TABLE XIV

Building Societies, 1913 and 1938–1953

	Building Societies			
	Number of Societies	*Number of Share Investors* *Thousands*	*Share and Loan Capital* *£ Millions*	*Mortgage Advances during Year* *£ Millions*
1913	1,551	617	62	9
1938	971	2,153	717	137
1939	960	2,154	711	94
1940	952	2,088	694	21
1941	947	2,040	688	10
1942	931	2,010	691	16
1943	924	2,021	708	28
1944	905	2,049	734	53
1945	890	2,065	760	98
1946	874	2,055	810	188
1947	858	2,069	882	242
1948	847	2,112	960	264
1949	835	2,178	1,057	276
1950	819	2,256	1,168	270
1951	807	2,359	1,265	268
1952	796	2,464	1,383	266
1953	782	2,616	1,540	298

TABLE XV

Friendly Societies and Insurance Companies, 1913 and 1938–1951

	Friendly Societies	Collecting Societies	Industrial Assurance
	Funds at End of Year £ Millions	*Premium Income £ Millions*	*Premium Income £ Millions*
1913	?	3	17
1938	152	15	58
1939	156	16	60
1940	159	16	62
1941	166	17	64
1942	173	18	68
1943	180	19	72
1944	187	20	76
1945	193	21	79
1946	198	22	84
1947	204	24	91
1948	206	26	97
1949	208	28	100
1950	210	28	103
1951	212	29	108

Life Assurance Companies—Ordinary Business

	Total Income £ Millions	*Total Outgoings £ Millions*	*Difference £ Millions*
1913	49	38	11
1938	142	102	40
1939	138	118	20
1940	133	121	12
1941	132	105	27
1942	137	103	34
1943	145	107	38
1944	151	111	40
1945	165	114	51
1946	193	123	70
1947	207	129	78
1948	225	138	87
1949	239	150	89
1950	261	159	102
1951	298	186	112

TABLE XVI

BRITISH ASSURANCE COMPANIES (all types), 1937, 1950, and 1951

	Assets £ Millions		
	1937	1950	1951
British Government Securities	374	1,167	1,140
Other British Commonwealth Securities	116	146	150
Foreign Public Securities	92	185	196
Loans to Public Bodies (U.K.)	121	97	100
Debentures	280	329	373
Stocks and Shares, Preferred	143	257	266
Stocks and Shares, Ordinary	173	373	412
Mortgages	191	258	311
Loans on Policies and Personal Security	51	31	35
Land and Houses	97	197	229
Other	108	329	389
	1,746	3,369	3,601

companies, or existing companies desiring to raise additional capital, instead of offering their shares directly to the public, sell them in the first instance to financial agencies or syndicates which buy them in bulk with a view to re-selling them to the public at a higher price. The issuing company and the purchasers of its shares then try to arrange with the London Stock Exchange (or with a provincial stock exchange) for an 'introduction' which will entitle the shares to be dealt in, though they have not been previously offered to the public; and the agencies which have purchased them from the promoters then trade them off as opportunity allows.

This practice first arose, except in the provinces, where it provides the most convenient way of marketing shares of mainly local appeal, as a method of evading the requirements of the Companies Acts in respect of new capital issues. The normal method contemplated in these Acts of offering shares to the public is by the issue of a 'prospectus', in which the conditions and prospects are supposed to be fairly and fully set out. Stringent legal penalties are laid down against mis-statement or failure to disclose relevant facts in a prospectus appealing to the public; and the practice of issuing new

shares by 'offer for sale' instead of prospectus arose largely because the offerers for sale were under no legal obligation to make full disclosure of the relevant facts. Legally, they were in the same position as any other person who offers for sale a second-hand share and has no means of knowing more than the company directors choose to tell him about the position of their concern. The Companies Act of 1928 to a considerable extent tightened up the conditions in this respect, by making the intermediaries who buy new shares in bulk and then set out to re-sell them at once by means of a public 'offer for sale' subject to the same legal requirements as the issuers. But the new regulations left still untouched the alternative method of re-sale by stock exchange 'introduction', without any public 'offer for sale'. The 1928 restrictions by no means put an end to 'offers for sale', though they removed many of the objections to them. Side by side with them continued to flourish the method of stock exchange 'introduction', safeguarded only by some tightening up of the conditions insisted on by the Stock Exchange Committee before it allowed new shares to be admitted to the Stock Exchange List and officially dealt in. The Committee undoubtedly did its best to get rid of the more obvious abuses; but it left the sale of shares by this method still ungoverned by any legal regulations such as apply to recognized public offers of new capital holdings.

A further Committee on Company Law was set up under the Chairmanship of Mr. Justice Cohen in 1943, and reported two years later. The Cohen Report advocated a further stiffening up of the legal requirements in a number of respects, but did not propose any really far-reaching changes. Its most important proposals were that the method of 'stock exchange introduction' should no longer free directors from the responsibilities for false statements which they would incur in the case of a prospectus or 'offer for sale'; that penalties should be attached to suppressing relevant facts as well as to stating falsehoods; that 'nominee holdings' should be disclosed wherever a single holder is the beneficial owner of more than 1 per cent. of the capital; that the London Stock Exchange Committee should continue and strengthen its control over the admission of new issues by 'permission to deal', and that provincial stock exchanges should adopt similar regulations to those in force in London; that there should be more intelligible information disclosed in profit and loss accounts; and that all holding companies should publish full consolidated accounts of the operations of their subsidiaries.

These recommendations were all in the right direction; but they left the immunities of private companies almost untouched, and went only a small distance in the matter of nominee holdings. The Report was on the whole a conservative document, lagging behind the best practice of existing companies; but its recommendations were, even so, much too drastic to please the special groups in the City which are mainly concerned with company finance. Many of the recommendations were embodied in the Companies Act of 1947 and in the Consolidating Act of 1948.

Finally, a word must be said about the Insurance Companies and the Building Societies, which have become the largest agencies for gathering up the savings of the working and middle classes. The extraordinary increase in the volume of voluntary insurance in all its forms, from small-scale funeral insurance to the life and superannuation policies which are common to the middle and upper classes, has placed in the hands of the Insurance Companies huge funds which are available for investment. A part of these funds flows out into gilt-edged securities yielding an assured return; but the Insurance Companies have also become important sources of capital for industrial and trading enterprises, particularly in such growing branches of production as automobiles and electrical goods, and in connection with the finance of hire-purchase schemes and the erection of blocks of business premises or residential flats. Meanwhile, the Building Societies have been gathering together immense funds from depositors chiefly of the middle classes, and have been applying this money to the finance of house-purchase on the instalment plan. Before 1939 there were signs that the sums which savers were disposed to deposit with Building Societies were tending to exceed those which the Societies could place in advances for house-purchase—the more so because repayments of sums advanced earlier were mounting up rapidly and had also to be put out again in new advances. The shortage of outlets in the field of housing was beginning to drive the Building Societies into other forms of investment yielding, on the average, a lower rate of return; and during the war the Societies lent very large sums to the Government in subscriptions to the various War Loans. But since 1945 the Building Societies have made a remarkable recovery, despite the greater proportion of houses built with public funds. By 1952 their annual mortgage advances were nearly twice as high (in money) as in 1938. Their capital holdings had risen from £717 millions in 1938 to £1,393 millions in 1952—which meant that in real terms they had

not yet regained their pre-war level. The number of societies, chiefly as a result of amalgamations, had fallen from 971 to 796. Building Societies have provided a very satisfactory means of investment for middle-class savings, largely because of the exceptional treatment accorded to them under income-tax law.

Building Societies cater to some extent for working-class as well as middle-class savers; and Insurance Companies, of course, draw a large proportion of their premiums from small weekly payments made by working-class households. For the working classes, the consumers' Co-operative movement offers an important outlet for small savings, both through share-capital, which is largely accumulated out of the dividends payable on purchases made in the Co-operative Stores, and through deposits in the local Societies and loan investments and deposits in the federal Co-operative Wholesale Societies for England and Wales and for Scotland. Friendly Societies and Collecting Societies—the latter more analogous to Insurance Companies than to veritable Friendly Societies such as the Odd-fellows and the Foresters—also accumulate considerable sums out of the weekly contributions of their members; but the size of their funds is small compared with that of the resources disposed of by the great Insurance Companies and the Building Societies. So far, their position has been remarkably little affected by the wider public provision of social insurance under the Act of 1946.*

For completeness, we must add to this list of financial agencies the Post Office Savings Bank, the National Savings Certificates which are sold to the public by the propaganda of the National Savings Committee, the Trustee Savings Banks, and that *rara avis*, the Birmingham Municipal Bank. The Post Office Savings Bank collects funds from small savers (including the children of well-to-do people) and lends these funds to the Government in return for an interest payment of $2\frac{1}{2}$ per cent. The National Savings Committee and the numerous thrift clubs created under its auspices, largely in factories and offices, similarly provide funds for government use, the interest accumulating over a period of years and being added to the cash value of the Certificates. The Trustee Savings Banks collect small savings which they re-invest in securities of a trustee type, and act as savings bankers for their depositors in the same way as the Post Office Savings Bank; while the Birmingham Municipal Bank places its deposits at the disposal of the Birmingham

* See Tables on pages 220 ff.

Corporation, which is to that extent enabled to reduce its dependence on other forms of borrowing or short-term credit.

This chapter has been mere survey. In the next, I shall proceed to consider the prospects of this network of institutions, which has grown up over a long period without any central plan. Will these various institutions all survive, or, if they do, will they keep their past functions and importance? Will new institutions be needed to meet the requirements of the coming period, or will the existing institutions be adapted to serve new purposes? To what extent is it likely that there will be further measures for the public operation, or control, of the financial system; and, to the extent to which these new tendencies do develop further, how far will the State need to devise new political and administrative machinery for exercising its control? To these questions we must now turn our attention.

X

PUBLIC CONTROL OF BANKING

THE banking system which a country needs depends on the general structure of the economic institutions into which it is required to fit. In a country such as the Soviet Union, where production and distribution are alike completely planned and all the major resources are owned either by the State or by some sort of 'collective' and administered in accordance with a public economic plan, it is plainly logical and natural for the banks to be public institutions and for the entire distribution of credit, as well as its total amount, to be settled as part of the plan. In such a country, the allocation of man-power and other productive resources, including that of investment in new capital resources, is decided as a matter of public policy; and it is the task of the banks to supply the credits which are needed to enable the various producing and distributing agencies to carry out their assigned parts of the total plan. The sums needed for this purpose will of course depend on the incomes paid out in wages and salaries and on the prices placed upon the goods supplied both to final consumers and at the intermediate stages of production and distribution. But neither wages and salaries nor prices will be left, in such an economy, to find their own levels. Wages and salaries, as well as social service payments, will be fixed by the public authorities, with such elasticity as is deemed desirable for incentive payments related to output; and prices will also be fixed, at any rate for many kinds of necessary goods. When production increases faster than population, it will be open to the authorities either to increase wages and other incomes or to reduce prices to consumers; and the decisions taken on these matters will affect the amount of monetary circulation that is needed. The banks, whether it be a matter of determining the total flow of credit or of allocating it among the various claimants, will be required to do whatever such policy decisions about production, incomes and prices call for. They will be simply a component in the general structure of a socialized economic system, and it will be natural for the State to appoint their directors and to give them such orders as it thinks fit. Banks, under these conditions, will no doubt have their autonomous administrations like other forms of business, and their managements will be left free from day-to-day interference pro-

vided they carry out the orders they are given. But the banking administration as a whole will tend to be highly centralized, because monetary policy will have to be closely co-ordinated with the central control of the entire structure of incomes, prices and production.

In such an economy as the Soviet Union's, the socialization of banking is indispensable. It is not equally to be taken for granted that in countries where private capitalist enterprise is the predominant system banking will be left entirely in private hands. The function of regulating the supply of money is too vital a matter in any type of economy to be left entirely uncontrolled. Wherever some sort of Central Bank exists and is in a position to influence the supply of currency or credit to a substantial extent, even the most *laissez-faire* Government is bound to lay down rules within which such a bank is to act and to interfere with its operations when they run counter to government policy or are felt to endanger the national interest. In some 'private enterprise' countries the Central Bank is a private institution owned by shareholders; but it needs powers which can be conferred on it only by the national Parliament and gets these powers only under conditions which it is bound to observe. At the very least, when the Central Bank issues the main part of the currency, there are rules governing the quantity of notes it is allowed to issue—sometimes with a proviso that the Government can allow it to exceed the permitted limit, or can alter the limit, with or without the Parliament's special consent. As we have seen, there is in most cases either a 'fiduciary limit'—that is to say, only a fixed amount of notes can be issued without 100 per cent. gold backing or its equivalent, or a proportional requirement—that is to say, a fixed ratio between the number of notes that can be issued and the amount of gold or of its equivalent held as a backing for them.

It is, however, not enough for even the most *laissez-faire* Government to regulate the note issue, unless it can be assured that this will in turn govern the supply of credit. Accordingly, whether formal regulations on this matter exist or not, the Government will want an assurance that the Central Bank, as far as it controls the supply of credit, will not act against the public interest, or in such a way as to prevent the Government from carrying out its general economic policy. In the days when the gold standard was allowed to operate almost uncontrolled, so that the supply of currency was regarded as fluctuating under the influence of economic forces which were out-

side national control, it could be regarded as enough for the Government to prescribe the conditions under which the Central Bank was to act, and then leave it to act within these conditions as a mere interpreter of economic forces in determining the supply of notes. But where the Central Bank was also the Government's banker it was also part of its function, on occasion, to help the Government to borrow on favourable terms, especially in conversion operations designed to reduce debt charges; and for this and other purposes it was required to intervene in order to make money scarce or plentiful within the limits of what could be done under gold standard conditions of exchange.

Nowadays, even the most *laissez-faire* Government is bound to require much more than this. For every Government, whether it wishes to or not, has to a considerable extent to plan, at any rate in the field of international economic relations. It has to concern itself with the balance of payments, with the handling of a large mass of national debt, with problems of private as well as public investment, and with the prevention of economic crises, which democratic electorates are no longer prepared to regard as 'acts of God' for which their Governments need accept no responsibility. Even in States which accept private enterprise as the right basis for the economic system, Central Banks tend to be either publicly owned or at least subject to a considerable measure of state control. Even in the United States the central banking system is partly socialized, and the un-socialized parts of it are regulated by the State.

Even, however, where central banking is publicly owned or controlled, or subject to considerable government regulation, the rest of the banks may remain in private hands. If the supply of credit is mainly determined by the Central Bank, it may seem unnecessary to control, except indirectly, the use made of it by the commercial banks which distribute it among would-be borrowers. Even in Great Britain, where a substantial fraction of the economy has been socialized, no attempt has been made so far to take over the commercial banks. If, indeed, a new Labour Government were to go much further either in the outright socialization of industries or in the regulation of those left under private ownership, it might be deemed necessary to convert the commercial banks into public institutions in order to ensure their compliance with the requirements of a more highly planned productive system. But this remains a disputed issue, even in the Labour Party. I shall come back to it later in this chapter. What the Labour Party did, when it found itself in

office in 1945 with a handsome majority behind it, was to socialize the Bank of England, and to endow it with power, in the last resort, to issue instructions to the commercial banks, while allowing the latter to remain in private ownership.

The Labour Party, when it took office in 1945, had long been committed to bringing the Bank of England under full public ownership, in order to ensure its conformity to any plan of economic or monetary development that a Government pursuing a broadly Socialist policy might think necessary in the national interest; and the will to carry through a policy of nationalization had been reinforced by the events of 1931, when in the view of most Labour Party supporters the Bank of England, under Montagu Norman's leadership and under the influence of the American banking authorities, had played a considerable part in bringing about the downfall of the second Labour Government during the financial crisis. The Labour Party, on the morrow of that defeat, had also committed itself in 1932 to the nationalization of the commercial banks; but, when its leaders came to draw up the shortened immediate programme on which they based their appeal to the electors in 1945, this further measure was left out, and the opinion was expressed that, with the Bank of England under public ownership, it would be practicable so to control the commercial banks, without actually taking them over, as to make sure that they would not obstruct the working of a Socialist Government's plans of economic development. This view was affected by wartime experience; for under war conditions the commercial banks had been made to do, broadly speaking, whatever the Government required of them in the way of providing current finance for its own expenditure or of supplying credit needed by private contractors working on its behalf. It remained to be seen whether the wartime controls could be made to work with equal effectiveness in time of peace; but the Labour Government, desirous of lightening its socialization programme as far as it could, took the view that, with the Bank of England converted definitely into an instrument of government policy, it would be enough to confer on it certain limited powers of control over the commercial banks, and that the extension of public ownership to them could be safely postponed to a later stage of the transition to a Socialist economic system.

In considering the whole question of state control of banking, let us begin with the position of the Bank of England as it was before the State took it over in 1946. The Bank was already a public institu-

tion, in the sense that it had been set up by Act of Parliament and owed its powers to its Charter, which Parliament had from time to time amended and renewed. It was a private institution, in the sense that its capital was privately owned and earned profits for the shareholders, its Court of Directors was privately appointed by the shareholders, and its lawful governing authority in the last resort was a shareholders' meeting. One has, however, only to state this latter set of propositions to make it plain that the form and the substance did not agree. The Bank's capital was privately owned, and in theory the directors could have declared what dividends they pleased out of their profits. But in fact the Bank had paid for a long time a stabilized dividend, which had become in effect a high fixed rate of interest on its capital. Its profitability was so well assured that those in charge of it did not need to be influenced in their actions by the profit motive. Moreover, the profits of the Bank were not really determined, like the profits of ordinary business, by its trading operations. They depended also on intricate financial arrangements with the Treasury, representing the Government. If, for example, the Bank stood to make a large windfall profit through a change in the gold value of sterling, as it actually did in 1931, no one suggested that the directors should have a right to dispose of this profit as they pleased, without the State having the last word about its disposal. Such profits, arising from the Bank's functions as guardian of the currency, were regarded as the State's property, even though they might accrue in the first instance to the Bank. They did not formally accrue in 1931, because the Bank, doubtless after agreeing with the Treasury, took no step to write up its gold reserve to its enhanced sterling value.*

Again, though the Court of Directors was virtually a self-co-opting body as far as the general body of shareholders was concerned, there was no doubt that close consultation should take place between the directors and the Treasury when it was a matter of appointing new directors or a new Governor. The Bank and not the State appointed; but normally the two agreed about the appointment. What would have happened if they had disagreed it is not easy to say. The State presumably could not have overridden the directors without going to Parliament for the necessary authority; but neither could the directors have flouted the Treasury without considering very seriously what the consequences would be. In

* The Bank's gold reserve was later, as a war measure, taken over by the Exchange Equalization Fund—that is, by the Government. See page 43.

effect, the Bank and the Treasury were accustomed to act so closely together that the question 'Which controls the other?' was really unanswerable.

On the score of these facts, some people concluded that the Bank of England was already in substance a nationalized institution, and that it would make no difference if it were formally taken over by the State. This, however, was not entirely true. Even if the State had great influence in the affairs of the Bank, it remained a fact that the Governor had always been chosen from circles of high City finance, that the Court of Directors was almost wholly representative of capitalist business interests, with the merchant bankers still holding a high representation, and that the whole tradition of the Bank was that of a great City institution, belonging to the world of high finance, and proud of its independence *vis-à-vis* the Government. Its relations with the Government were those of treaty rather than of subordination; and it had been made clear in 1931 that, when the Bank found itself confronted with a Government that it disliked, it could by no means be taken for granted that the word of the Government would prevail.

The Bank of England, it was argued, was already in effect a 'Public Corporation', analogous to the London Passenger Transport Board, the Central Electricity Board, and the British Broadcasting Corporation. So, up to a point, it was; but the very notion of 'Public Corporation' means different things to different people. It is generally accepted that a Public Corporation should differ from a government department in that its administrators should be left free from day-to-day political or parliamentary interference, should not be subject to the day-to-day control of a Minister or a civil service departmental chief, and should not be under the Treasury in the same way as a regular civil service department. But most people would hold that the Board of a Public Corporation should normally be appointed by the Government. Moreover, all who favour any real system of public economic planning are bound to hold that Public Corporations, however much independence they may enjoy in their executive acts, should be expected to carry out general policies in accordance with the requirements of the Government's economic plans, and to accept general directives from the Minister or Ministers responsible for the operation of these plans.

Indeed, those who argued that no change was needed in the status of the Bank of England did not mean that it was already subject to government control, but that it ought not to be. They wanted to

preserve the Bank's independence to frame its own policy apart from the Government, and to stand out, when it saw fit, against the Government in such a way that it could be coerced only by legislation. They wanted to keep banking, including central banking, 'outside politics'—which meant in effect that they wanted to use it as a bulwark against the kinds of politics of which they disapproved: whereas those who favoured economic planning and held that the Government ought to assume the responsibility for maintaining the volume of production and employment affirmed that monetary policy must play so vital a part in this as to be brought necessarily within the realm of politics as soon as such a responsibility was accepted by the State.

In practice, in the situation which existed after 1945, it was quite out of the question for banking and politics to be kept apart, any more than they could be in time of war. Every European country west of the 'iron curtain' was suffering from balance of payments difficulties which made it indispensable for the State to keep a tight hand on everything which could be used to control this balance; and scarcity of real resources made it necessary both to control the use made of what there were, and to prevent their prices being forced up by the excess demand. The control of credit was an essential part of this wider control of the whole economy; and in addition the need to manage the swollen National Debt, and especially the greatly increased part of it made up of short-term borrowing which had to be continually renewed, linked the processes of government finance and of central banking so closely together as to make unified responsibility for general policy indispensable.

It is therefore not at all surprising that the Labour Government of 1945 decided to give a high priority to the nationalization of the Bank of England, even if national ownership was not likely to lead to any considerable immediate change in the working or policy of the Bank—which, under war conditions, had already passed under effective government control. As long as the Bank remained a private institution, its immunity from defined responsibility to the State presented a vague but continuous threat to the Government's power. The buying out of the Bank's shareholders obviously had to be undertaken, not because the shareholders were themselves of direct importance (though in fact the Bank's shares were jealously kept in the hands of a narrow oligarchy of high finance), but because the shareholders, and not the Government, were the persons

to whom the directors were formally responsible, by whom they were formally appointed, and to whom they might, in the event of a conflict of policy, feel their final allegiance to be due. The State, clearly, if its rulers were set on following a socialistic policy, had to replace the private shareholders as the owner of the Bank's capital, and had to appoint the persons who were to take charge of the Bank's affairs.

What sort of persons should the State appoint? For the offices of Governor and Deputy-Governor, clearly the best men it could find, not as representatives of any particular interest or group, but as servants of the public. As for the directors, there was room for difference of opinion. The Labour Party, in its pre-1939 proposals for the nationalization of the Bank of England, had advocated a representative Court of Directors, chosen from different sectional groups—industry, commerce, finance, labour, and so on. In the event, however, it decided to take a different course. In 1946 it re-appointed the old directors whose periods of office had not expired, and merely substituted a few new men, by no means drawn only from its own party, for those whose terms had run out. It was, indeed, always a moot point whether a formal scheme of balanced representation was really expedient. It is, no doubt, always desirable to have on the Court persons of experience and standing in a number of different fields; but it may have been wise to choose them as individuals, rather than as representatives of particular interests. The place for formal representation, if there is one, would seem to be rather on some sort of Advisory Council than on the body which is actually to govern the Bank's affairs. A small, full-time Court of individuals chosen for their personal competence, aided by such a Council, might give better service than the present fairly numerous body; but such a change would probably make no great practical difference to the working of the Bank.

It is to be observed that in almost all countries except Great Britain the executive head of the Central Bank has long been appointed by the Government, and that in most the Government has an important share in the appointment of the directors. Practice varies a good deal from Bank to Bank, some Central Banks being in effect State Banks and others private corporations subject to a measure of public control, with all sorts of intermediate varieties. In the United States the position is complicated by the existence of twelve separate Federal Reserve Banks, co-ordinated by a central Federal Reserve Board, and by the division between the Banks and

the Board of the functions ordinarily performed by a Central Bank. The United States Federal Reserve Board, which is the supreme body, is entirely government-appointed, and is in effect a part of the machinery of State; and the Board has an important voice in choosing the directing personnel of the Federal Reserve Banks. It appoints three out of the nine directors of each Bank, including the Chairman, who also acts as the Board's Agent for the district. Of the remaining six directors, three represent the commercial banks and three industry, agriculture, and commerce. The system as a whole is so designed as to ensure that the Federal Reserve Board shall be in matters of major policy the final controlling power.

Thus, even in countries which are regarded as standing pre-eminently for the system of private enterprise, the Government has usually a very large share in the direction of the Central Bank and its policy. The Government cannot effectively manage its own finances—let alone carry on a policy designed to promote full employment—unless it can be assured of the entire co-operation of the Central Bank. As long as power in Great Britain alternated merely between Liberal and Conservative Governments which did not differ greatly in their outlook on most economic questions and had no thought of assuming any responsibility for regulating the level of production and employment, no serious difficulty arose over the position of the Bank of England as a privately owned corporation, not subject to government control; for the policies of such Governments and of the Bank were not likely to clash. The Bank of England was a chartered private corporation, with its note-issuing powers regulated by statute. It acted as the Government's banker, and managed the National Debt on the Government's behalf. It was also the bankers' banker, holding on their behalf the main cash reserves of the commercial banks. In practice, it had long acted under 'gold standard' rules, relaxing or tightening credit conditions in relation to the inflow and outflow of monetary gold, and leaving the rest of the community to adapt itself as best it could to these changes. Up to 1914 it had, to all intents and purposes, sole control both of the note issue and, *de facto*, of the supply of gold coins, which it drew from the Mint as it needed them. It had in form lost this monopoly after 1914, when the £1 and 10/- Treasury Notes issued to replace the gold coins previously in circulation had been put forth under the auspices of the Treasury, and not of the Bank. But in practice the Bank issued these notes to the other banks, which passed them on to the public; and the change made little difference.

What did make a difference was that, in wartime, the Bank, instead of following the rules of the gold standard, had to accept the Government's view about the amount of notes to be issued, and became in effect a government agency. Then, in 1928, the issue of Treasury Notes was formally transferred to the Bank, which thus not merely regained its monopoly, but became responsible for the entire supply of currency, except the relatively small amount represented by token 'silver' and 'copper' coins of low denomination.

During the ensuing years up to 1931, the Bank of England was in an exceedingly powerful position. Up to 1929, it was acting in concert with the Conservative Government in endeavouring, by restricting the supply of means of payment, to keep the pound sterling at the restored gold value which it had been given in 1925, at the cost of damping down production and employment. When the second Labour Government took office in 1929, it was widely expected that there would be a clash between it and the Bank over credit policy, as both the Labour Party and the Liberals, on whom the Government depended for support in Parliament, had advocated during the election an active 'public works policy' for combating unemployment. But in fact the Labour Chancellor of the Exchequer, Philip Snowden, showed himself as fervent a devotee as his predecessors of the old financial orthodoxy, and fully supported the Bank in its opposition to any policy of financial expansion that would involve 'going off gold' or devaluing the currency. The clash came ultimately as a consequence, not of any policy deliberately inaugurated by the Labour Government, but of the world crisis which followed the collapse of the American boom in and after 1929. The withdrawal of American investors from Europe in an attempt to meet the domestic crisis of the American economy spread the depression to Europe and the rest of the world. Buying power was everywhere curtailed: from Germany and Austria to Japan there was a scramble to increase exports and reduce imports in the hope of restoring solvency; and Great Britain, as the greatest free market, found the unsaleable surpluses of other countries dumped upon it at the same time as British exports were being shut out by rising tariffs and prohibitions. Unemployment rose, in one country after another, to unprecedented heights; and in 1931 Great Britain was forced off the recently restored gold standard by the sheer exhaustion of its reserves. Before this happened, though not before it had become inevitable, the Labour Government, which was clinging foolishly to the gold standard, was forced out of office;

and the National Government headed by Ramsay MacDonald, which replaced it with the alleged mission of maintaining the gold value of the pound intact, had immediately to suspend gold payments and to allow the pound to depreciate in terms of the dollar and of other currencies of which the gold value was maintained.

In these events, the Bank of England played a part that is still subject to dispute. In the hopeless attempt that was made to preserve the gold standard the Bank of England, with government backing, borrowed heavily from the Federal Reserve Bank of New York and from the Bank of France, only to find that the borrowed resources were swallowed up at once by the 'flight from the pound'. Persons who held sterling, regarding a fall in its value as unavoidable, made haste to convert their sterling into gold or dollars; and the more this was done, the more speculators came in to swell the flood of demands to get rid of sterling and acquire currencies that were felt to be safer—or gold—in exchange. It is undisputed that, at a certain point, the New York Federal Reserve Bank refused to make further loans to the Bank of England unless the British Government agreed to make large cuts in its expenditure, including reductions in the benefits paid to the unemployed. Nor is it in dispute that Philip Snowden and the Governor of the Bank of England, Montagu Norman, pressed acceptance upon the Government, or that, when the Cabinet had failed to agree on a policy, MacDonald, Snowden, and a few others threw over their Labour colleagues, and joined forces with the Conservatives and Liberals in a 'National' Government which first announced its mission to save the gold standard, and then quickly abandoned it because they had to.

The part played by the Bank of England in these events is, however, still not wholly clear. Did the Bank, as was claimed later, merely wash its hands of responsibility, and merely transmit an ultimatum delivered by the Federal Reserve Bank of New York? Or did it play some part in procuring the ultimatum, and then press its acceptance on the Government? Most of the members of the Labour Cabinet thought that they were being subjected to pressure by the Bank; but how much of the pressure came from Montagu Norman, how much from the United States, and how much from Philip Snowden himself will probably never be fully known. The Bank may in form only have transmitted a decision of the American banking authorities not to come to the further aid of sterling unless expenditure on the unemployed were cut down. But the line of difference is fine; and it is a pertinent point that discussions with the

Americans were carried on by the Bank, not as a government agency, but as an independent body negotiating with the British Government as well as with the American authorities, and not receiving its orders.

At all events, the Bank was widely believed to have played in 1931 a leading part in overthrowing the Labour Government; and there was left behind a legacy of mistrust that was bound to lead to socialization by any subsequent Labour Government that could command a parliamentary majority. In France, the Blum Government of 1936 encountered at least as serious difficulties with the Bank of France when it attempted to carry out an advanced social policy. The consequence in that case was that the appointment of Governor was taken over from the Bank's shareholders by the State; but the Bank of France retains even to-day a considerable power to obstruct a weak Government which it considers to be guilty of unorthodox financial practices. In these circumstances, advocates of a planned employment policy were bound to insist that the Bank of England ought to become a publicly owned Corporation, and that those who directed its affairs ought to be public servants appointed by the State, whether or not some element of non-official representation should be retained. It did not, however, at all follow that they would wish the socialized Bank to be subject to any interference beyond what was needed to ensure its compliance with the Government's general economic policy. No one wanted the Bank to be subject to day-to-day control in its ordinary operations. What was asked for was that the Exchange Equalization Fund, which the Bank operated on the Treasury's behalf, should be managed in accordance with government monetary policy, and that the Bank itself should accept the function, in relation to the regulation of credit, of carrying out the Government's employment and investment policies, and should to that extent cease to be independent of government control.

As long as the old gold standard was in operation, the value of the national currency was fixed by decision of the State, and was not meant to be subject to change. It was not fixed by the Bank of England. When, however, Great Britain left the gold standard in 1931, the determination of the value of sterling, to the extent that it was not left to the working of blind forces, rested with the authorities in control of credit policy and with such instruments as might be set up to influence the course of the exchanges by special means. We have seen that the Exchange Equalization Fund, from its establish-

ment, was put under the Treasury and only managed on its behalf by the Bank of England. If, thereafter, the Fund and the Bank had followed divergent policies, chaos would have been the result. The credit policy followed by the Bank and the equalization policy followed by the Fund had to be closely concerted; and the Treasury and the Bank had to work together in pursuance of a common policy. Which of the two had actually the greater influence was a matter of personalities rather than of formal regulations; but it can hardly be questioned that, if differences arose under such a dual arrangement, the State's voice ought to have the final power to prevail. This was, indeed, explicitly affirmed by the Bank, whose Governor always asserted that after 1931 the final responsibility for monetary policy rested with the Treasury, and not with the Bank.

Monetary policy is bound to be an exceedingly important issue for a long time to come; for the problem of finding new relative levels for all the world's currencies and of settling afresh the part which gold is to play in the world's monetary systems is still, in 1954, a long way off solution. I shall be discussing these problems in a later chapter: here I need only make the obvious point that the regulation of credit policy and the management of the foreign exchanges have to be integrated under a single authority, which under the conditions of the modern world can be only that of the State. Internationally binding agreements have to be made; and these have to be agreements between Governments, and not merely between Banks. Bankers' conformity has to be made secure—nay more, their positive co-operation with the Governments has to be ensured. But how can it be, unless Central Banks are made clearly subordinate to the State, and treated as an integral part of the public machinery of economic regulation in both national and international affairs?

Let us now turn to the commercial banks, which are still private concerns, over which up to 1946 the State had in theory no control at all except in time of war. They have boards of directors appointed by their shareholders: they make profits, and declare dividends, in theory, just like any other joint stock company. There are, no doubt, some special provisions relating to them on the statute book; but these amount to very little, and before 1946 there was no statute conferring any right of state interference in the control of their affairs. Yet, despite formal appearances, the joint stock commercial banks were not entirely like ordinary companies. They did not, as we have seen, go all out to make as much profit as they could,

regardless of consequences. They paid, in the main, stabilized rates of dividend analogous to those paid by the Bank of England; and usually, like it, they found no difficulty in earning, in good and bad times alike, enough profit to pay out regularly in dividends as much as they wanted to pay. Their very profitableness rendered them immune from the need to be guided exclusively by considerations of profit: like the Bank of England, they were run, not so much to make profits for themselves as to guarantee, within their rights, that the conditions of profit-making should be secured for others.

There is only one Bank of England; but there are in Great Britain a dozen or more joint stock commercial banks, not counting the Scottish and Irish banks, which work in association with them. Pre-eminent among them are the 'Big Five'—the Midland, Lloyds, Barclays, the Westminster, and the National Provincial—all the outcome of a large number of bank amalgamations by which local banks have been absorbed and national banks consolidated into bigger units. To a certain extent, these banks compete one with another for custom, and offer slightly varying facilities. But they work closely together, and follow in all major matters a policy in common. How far is it desirable that any change should be made in their relations, either with one another or with the State? Or is it more desirable that they should all be amalgamated into a single State Bank?

Proposals for the socialization of the commercial banks meet with strong resistance in many quarters, chiefly on three grounds. There is, first, the fear that the State, if it controls the banks, will get to know too much about people's private and business affairs, and that the tax-gatherer may be equipped with a new weapon—to say nothing of the police. The privacy of bank accounts is a matter to which many people attach much importance, for obvious reasons. There is, however, no reason why this privacy, as far as it concerns a man's neighbours or business connections, should be less secure under a system of state banking than it is to-day. The servants of the State have many faults; but they are not given to blabbing. Privacy in relation to the State itself is, however, a somewhat different matter. It is a nice question whether an income-tax collector who thinks the State is being defrauded should have a right to go to a state bank manager and demand information about his client's account. Even with the banks in private ownership, nice questions arise in similar connections in respect of the law courts and the police. There is, however, nothing in public ownership of the banks

TABLE XVII

British Banking, 1938 and 1945-1953

	Bank of England		*Clearing Banks*		*Distribution of Gross Deposits—%*					*Total Amount of Treasury Bills*	
	Bankers' Deposits £Mn.	*Notes in Circulation* £Mn.	*Net Deposits Lloyds Bank Index* 1938=100	*Gross Deposits* £Mn.	*Cash*	*Money at Call and Discounts*	*Investments*	*Advances*	*Treasury Deposits*	*Tender* £Mn.	*Other* £Mn.
1938	104	485	100	2,277	10·6	18·9	28·0	42·9	—	547	330
1945	207	1,284	205	4,692	10·5	8·4	24·6	16·3	38·6	1,602	2,288
1946	242	1,358	222	5,097	10·3	14·8	26·4	17·4	29·3	1,902	2,534
1947	295	1,385	246	5,650	8·4	20·7	26·1	19·6	23·1	2,193	2,549
1948	303	1,252	258	5,913	8·2	20·5	24·9	22·3	21·7	2,210	2,507
1949	296	1,270	260	5,974	8·3	23·8	25·2	24·1	16·4	2,400	2,345
1950	292	1,289	262	6,014	8·3	30·7	25·0	26·7	7·1	3,070	1,895
1951	298	1,342	267	6,162	8·3	29·2	26·4	29·6	4·0	5,160	
1952	277	1,435	264	6,083	8·3	26·1	32·6	30·2	0·1	4,974	
1953	278	1,532	—	6,256	8·1	27·1	34·6	27·7	—	5,104	

TABLE XVIII

Commercial Bank Profits and Dividends, 1950-1952

£000s	1950	1951	1952	*Rate of Dividend 1952*	*Price of £1 Paid Share, end of 1952*
Barclays . .	1,972	1,908	2,138	14	58/6
Lloyds . .	1,762	1,816	1,965	12	48/3
Midland . .	1,987	1,925	2,075	16	64/–
Nat. Provincial .	1,455	1,470	1,525	16	59/6
Westminster .	1,471	1,405	1,447	18	72/3
District . .	513	508	516	18½	73/6
Martin's . .	733	725	746	15	60/6

TABLE XIX

Distribution of Bank Advances, May 1953

	£Mn.	*% of Total*
Personal and Professional . .	369	19·7
Agriculture and Fishing . . .	198	10·6
Retail Trade	177	9·5
Engineering, etc.	160	8·6
Food, Drink and Tobacco . .	146	7·8
Public Utilities (except Transport) .	99	5·3
Textiles	84	4·5
Local Government . . .	76	4·1
Building and Constructing . .	61	3·3
Iron and Steel	52	2·8
Chemicals	27	1·5
Entertainment	23	1·2
Transport	18	0·9
Shipping and Shipbuilding . .	17	0·9
Building Materials	17	0·9
Rubber and Leather . . .	16	0·8
Charities, Hospitals, etc. . . .	13	0·7
Mining and Quarrying . . .	7	0·4
Stockbrokers	6	0·3
Non-ferrous Metals . . .	5	0·3
Other Industries and Trades . .	112	6·0
Other Financial	184	9·9
	1,867	100

that implies either that there should, or that there should not, be access to information about private or business accounts for the revenue departments. Any Act socializing the commercial banks could explicitly exclude such access, or could allow it only under defined conditions. This answer will not satisfy those who are hostile to bank socialization, or to public enterprise generally, on other grounds. But it is a fair answer to those who use the argument as their main objection to public ownership.

The second objection that is often raised to socialization of the commercial banks is that state banks would discriminate in granting or refusing loans, and that the granting of loans to particular firms or persons would become a political question. To a certain extent under any *planned* economic system, the distribution of credit is bound to become a matter of public concern. If there is to be a public plan of production prepared by the Government and approved by Parliament, the finance needed for the plan must be made available, whether the banks are publicly owned or not, and credit must not be so granted or refused as to upset the plan. If the State had decided to plan for full employment, on the basis of an expansion of such and such forms of production and a development in such and such depressed areas, and if the privately owned banks then refused to supply credit in accordance with the requirements of the plan, there would be a deadlock, which could be resolved only by the banks being coerced into conformity, or by the State starting a rival bank of its own, as happened in Australia under rather different circumstances, or by the plan breaking down. To this extent, at any rate, a planned economic system implies some public control over the commercial banks as the suppliers of short-term financial accommodation.

Discrimination between types of investment, in accordance with the needs of a general economic plan, is, however, a different matter from discrimination between individual firms. It would obviously be most undesirable to create conditions under which the head of a particular business could hope, by approaching a Member of Parliament, to get more liberal credit than he would be accorded in the absence of such an approach. State-owned banks would have to be safeguarded from political interference of this sort, and from questions in Parliament designed to secure advantages for particular firms at the expense of others. It would be fully as necessary for publicly owned commercial banks as for the Central Bank to be given a wide freedom and an immunity from interference in day-

to-day administration. In practice, a plan of production would necessarily involve in many cases arranging for particular businesses to carry out certain parts of the plan, just as when the State orders a battleship it has to place the order with a particular contractor. All public works, except those which are carried out by public enterprises, involve such allocations of work to particular firms; and just as the banks now supply the credits required for such contracts, the socialized banks would have to do the same. Planning for full employment no doubt means more than this, in that the State makes itself responsible for stimulating private production as well as for extending the range of its own orders for work; and here again the banks, socialized or not, have to provide the credits needed. Beyond this, there is no reason to suppose that the State would wish the banks to exercise any discrimination in favour of one firm rather than another, except upon very special grounds.

State operation of banking could of course be used as a means of refusing credit to firms which did not comply with public requirements in such matters as the payment of fair wages and the observance of fair labour conditions. But such discrimination could not, in a country such as Great Britain, be applied arbitrarily, or without due process. At one time the American Government attempted to enforce the law against child labour by refusing the use of federal postal facilities to firms which did not abide by it. Action of this sort in the field of credit would be possible, but only against proved offenders; and why should anyone wish to rally to their defence?

It is sometimes suggested that state-run banks would discriminate in favour of the big, and against the small, employer. In Great Britain, at any rate, this seems unlikely. A similar charge is often advanced against the banks as they are, under private ownership; and we have seen that there is some substance in it, whatever the banks intend. State banking, however, is advocated chiefly by persons who believe that the great businesses ought to be brought under public control, but that small-scale business is the legitimate field for private enterprise. It is much more likely that State Banks would go out to do all they could to help the small man and to provide special credit facilities for him as part of a comprehensive policy of full employment. In recent years quite a number of special institutions have been set up by state action to improve the supply of capital and credit for small and middle-sized businesses. The Government would be most unlikely to use its control of the banks to go counter to what it has been trying to do outside them.

The third objection to state banking is that it would be less safe for the depositors than banking is to-day. But this is sheer nonsense. Let us agree that British banking, as it is, offers a high degree of security to its depositors, and that no big privately owned bank would be allowed to collapse without the State, through the Central Bank, coming to its aid, if the other banks could not see it through. Surely, it is even clearer that the State could never allow a bank run under its own auspices to default. Would the depositors in American banks have been safer or less safe in 1933 if these banks had been publicly owned? Clearly safer; for the American Government, when it came to the assistance of the privately owned banks, did not guarantee all deposits, but only deposits in certain banks and up to certain limits. If the State had owned the banks, the depositors' money in them all would have been guaranteed.

The only sense I can imagine in which state banking could be less safe than private banking is that it might result in lower bank profits. An incautiously worded phrase to this effect in a lecture I gave many years ago has been made use of ever since by opponents of bank socialization, who quote it as if I had said 'less safe for the depositors', whereas the context made it plain that I meant 'less safe from the standpoint of bank profits', and that I was criticizing the commercial banks for playing too 'safe' in a derogatory sense—that is, for not being enterprising enough in backing hopeful projects. A state banking system might well serve its customers more cheaply and be less cautious than commercial banks have been in the past in financing progressive enterprises; but this would be a merit and not a defect. In Great Britain the faults of the commercial banking system have been over-caution and excessive margins to cover costs and risks.

But is it *necessary* to socialize the joint stock commercial banks, even if socialization would not have any of the consequences of which its opponents profess to be afraid? It is not *necessary*, if the requisite degree of control can be secured without it, so as to ensure the conformity of the distribution of credit with the needs of balanced full employment. It may, however, be highly *desirable*, in order to facilitate the smooth working of a planned economy, and to ensure the cheapest practicable conditions of credit supply; and it will be absolutely *necessary*, in such an economy, unless the banks act as if they had been socialized, even though they have not. To a great extent they have been acting in this way, both during and since the war; but it does not follow that they will, in the absence of

effective control, always do so in time of peace if most of the persons in charge of them strongly dislike the complexion and policy of the Government in office. As we saw, the Bank of England is now empowered under the Bank Act of 1946 to issue directions to the commercial banks and, though these powers have not been formally used, has been from time to time giving them advice about the forms of enterprise it considers to be more credit-worthy than others in the public interest. The banks, in acting on this advice, have been discriminating to some extent between would-be borrowers on the score of their potential contribution to the easing of the nation's economic difficulties; and this type of discrimination has acquired more importance since 1951, when credit came to be more strictly limited in an attempt to achieve 'disinflation'. There was at the same time, under a Conservative Government, a desire to return to a greater acceptance of the 'laws' of the market, and to limit government interference to the assurance of the credits needed for re-armament and for the promotion of exports: so that the two tendencies to some extent counteracted each other. The power to issue directions to the commercial banks through the Bank of England remains in the background; but its efficiency in meeting a situation of sharp disagreement between government policy and banking opinion has still to be put to the test.

What, I am sure, is neither necessary nor desirable is to amalgamate all the existing commercial banks into one universal National Bank, so as to leave depositors no choice and bankers no room for emulation. The 'Big Five' are quite big enough—perhaps too big: an amalgamated bank bringing together all their business would be much too unwieldy for efficient working. There is, however, nothing in the policy of public ownership or socialization that makes it necessary to amalgamate the units taken over. If the commercial banks were to be socialized, it would be much better for each of them to be converted, by public purchase of its share-capital, into a Public Corporation, and to continue the separate banks as parts of a socialized banking system centred upon the socialized Bank of England. Under such a system, it would be undesirable to preserve the tradition of isolation of the commercial banks from the Central Bank. It should be easy to transfer men from one bank to another, or from one to another branch of the public financial service. The public should keep its choice of bank, and the banks their variety of methods; and new banks—for example, special banks for agriculture, or municipal banks—could be created accord-

ing to need, whereas now the creation of such agencies is commonly obstructed by the vested interests of the privately owned commercial banks. This would not prevent the number of small branches from being reduced in order to cut down costs; for, as already occurs to some extent, one village unit could serve as agent for all the banks, and clients needing special treatment could resort to the branch of their own bank in the nearest town.

The socialization of the commercial banks seems unlikely to be pressed on with as an urgent matter even if the Labour Party returns to power. Many of the party's leaders are afraid of the political effects of proposing it: they fear a 'stunt' misrepresenting it as involving a threat to confiscate bank deposits or to misapply them for meeting government expenditure. Undoubtedly, in 1931, very effective play was made, especially by Philip Snowden in an electoral broadcast, with a 'scare' of this sort; and, baseless though it is, it might well be effective again in frightening the ignorant. A Labour Government would probably rely on the power to issue recommendations and, if necessary, in the words of the Act of 1946, 'directions to any banker for the purpose of securing that effect is given to any such request or recommendation'. Only if the banks defied such direction would the socialization issue be raised again in the near future. The principle that the commercial banks have to do what the socialized Central Bank tells them has been laid down as law; and for the time being that is perhaps enough.

XI

THE INVESTMENT OF LONG-TERM CAPITAL

THE supply of long-term capital for British trades and industries comes partly through the market for new issues, through which shares and bonds are sold, directly or indirectly, to the investing public; partly—and increasingly—from reserves built up by existing companies and invested either in their own enterprises or in those of subsidiaries or allied concerns; and partly from such special sources as the Bank of England and the commercial banks, through the subsidiary agencies which they have set up in recent years for purposes of long-term investment, including the management of shares taken up between the wars in connection with the re-flotation of companies which had got into financial difficulties. The organization of the market for new issues is somewhat complicated. The older Issuing Houses—in effect, the old-established firms of merchant bankers—used to specialize mainly in issues for overseas Governments and municipalities and to take little part in the raising of capital for home industry. This situation has been changing in recent years; and some of these houses—notably Lazard Bros.—have taken an active share in the handling of new capital issues for home investment. Side by side with them are other Issuing Houses, large and small, good, bad, and indifferent, which range from considerable concerns handling a substantial number of issues to nominal Issuing Houses which are in reality little more than aliases for the firms for which they set out to raise capital.

There are, as we have seen, three main ways in which an issue of capital to the general investing public can be made. The oldest, and the most respectable, of these is the method contemplated in the earlier Companies Act—the publication of a 'prospectus' giving an account of the terms of the issue and disclosing, if the law is fully complied with, all the relevant facts bearing on the value of the shares. There are legal penalties for either making false statements or suppressing relevant facts in such a prospectus; and these penalties have in the main now been extended to those who sell shares to the public by the second method—that of 'offer for sale', without the publication of any formal prospectus. The issuer of the 'offer for sale' is not the company for which the capital is being raised, but the financial agency or syndicate which has bought its shares outright,

in the expectation of being able to re-sell them at a profit. This used to exempt the 'offering' concerns from most of the requirements of the Companies Acts concerning the disclosure of relevant information—on the ground that they were in the same position as any other sellers of second-hand shares and had no necessary access to the information possessed by the company itself concerning the state of its affairs. But such serious abuses developed from the use of 'offers for sale' as a deliberate way of evading the provisions relating to prospectuses that the law was altered; and firms or syndicates which buy up new issues for immediate re-sale to the public through an 'offer for sale' have been made subject to practically the same conditions as the original issuers of a prospectus.

This reform of the law failed, however, to cover the third method by which new shares can be sold to the public. Under this third method, that of 'stock exchange introduction', there is neither a published prospectus nor any published 'offer for sale'. The financial agency which has bought up the shares simply approaches the Committee of the Stock Exchange and asks its permission for the shares to be dealt in on the Stock Exchange and included in the printed Stock Exchange List. When this permission has been given, the financial agency (or, of course, more than one, if several have joined in the venture) proceeds to sell off the shares in parcels, managing the offers so as not to flood the market, and often arranging what are in effect fictitious deals in the shares in order to give them a good start.

Clearly, this throws a considerable burden on the Stock Exchange Committee, in deciding what new issues to admit or refuse. The increasing use of this method of raising capital has had some effect in leading the Committee to stiffen its requirements; but doubtful issues have still got past the test, and there is, of course, nothing to prevent dealings in issues which the Committee has rejected from taking place anywhere outside the London Stock Exchange. The restrictions on 'share-pushing' by canvassers and by mass-circularization included in the Companies Act of 1928 have done a good deal to restrict practices which had become notorious; but the safeguards under the present Companies Act—that of 1948—are still inadequate to prevent many issues of an undesirable kind from getting made and taken up at times when the investing public is in a hopeful mood.

Purchase of the whole of a new issue outright by a financial agency, or by several agencies acting together, is an alternative to the old-established practice of underwriting. The 'underwriters' of

an issue of shares or bonds agree, in return for an underwriting commission on the whole issue, to purchase at an agreed price, or rather at the public price of issue less a specified commission, all such parts of the issue as are not taken up by the public in response to the published prospectus. Usually, the firm which undertakes the underwriting shares its responsibility with others, 'sub-underwriters', who agree to take a part of the unsold shares or bonds off its hands. No such underwriting is needed when the body which arranges for the issue buys the shares or bonds outright for purposes of re-sale. What often happens, however, is that, whereas underwriters are persons with no interest in the shares apart from the underwriting, the agencies which buy up whole issues are hardly more than aliases for the companies whose shares are being dealt in. This need not be the case, and there are entirely reputable agencies which buy shares *en bloc*; but it is not easy for the public to distinguish between an Issuing House or financial agency which is a really independent body and one which is a mere financial auxiliary of the company whose shares it is endeavouring to sell.

The reason both for underwriting and for arranging for the purchase in bulk of the whole of a new issue, at the cost of commissions, which are often considerable, to those who perform these services, is that, when a company decides to start business or to raise additional capital, it has presumably in mind certain definite plans, involving an expenditure which can be broadly estimated in advance. If, say, the purpose is to build and equip a factory costing £100,000, and to have a further £50,000 available for working capital and necessary expenses, it is obvious that the company cannot carry out its plans unless it gets something approaching the whole £150,000 for which it asks. If, in response to its request for capital, only £75,000 were subscribed, the projected factory could not be built, and there would be serious danger of the money being lost should the company start business with inadequate equipment and without any working funds. Underwriting, or 'placing' with a financial agency, ensures that the entire amount asked for will be forthcoming, and is therefore a necessary precaution for which it is worth while to pay a reasonable commission. There is, however, a danger, especially when the entire issue is bought up at a discount by a financial agency, that the gap between the sum paid by the public for the shares and the sum accruing to the company may be much too wide—the difference being 'raked off' in financial operations for the benefit of persons who may have no long-run interest

in the company's prosperity, because they fully intend to get out as soon as they have raked off all they can.

This sort of abuse is found much more in the case of home than of foreign issues, because, even apart from the control exercised over foreign investment since the war, most foreign issues do not stand much chance unless they are sponsored by a thoroughly reputable Issuing House. Nor, of course, is this sort of abuse found in relation to such home issues as those of local government authorities, or public corporations, or well-established big industrial concerns. The offenders have been either speculative company promoters, trying to put across propositions of their own, or shady financial agents, who have made a business of finding private businesses which they can convert into public companies, or struggling firms in need of additional capital, and then of so arranging their affairs as to yield the largest possible 'rake-off' at the expense of those in whose hands the new shares are finally left.

Foreign issues raise certain special problems. The sending of capital overseas, unless it goes out immediately in the form of wholly British-made goods which would not otherwise have been exported, raises exchange problems. It means that the banking system—in effect, the Central Bank—has to find so much more foreign exchange; and this may raise difficulties if the current balance of payments is in deficit or leaves no surplus available for investment abroad. Accordingly, there has to be some control, formal or informal, over the amount of capital for overseas borrowers that is allowed to be raised by appeals to British investors. Up to 1931 this control was quite informal. The Bank of England, often in consultation with the Treasury and the big City houses, exercised an extra-legal censorship over issues of capital for overseas investment; and the old-established Issuing Houses which handled such transactions acted in close consultation with the Bank. After the departure from the gold standard in 1931, this procedure was stiffened up, and the Treasury took a more open part in it, pronouncing an embargo on overseas loans subject to such exceptions as it agreed to make. There was, however, still a considerable loophole; for many companies registered in Great Britain carry on business partly in Great Britain and partly overseas, and there was nothing to prevent them either from carrying overseas money raised by means of a 'home' issue of capital or from investing abroad sums accruing to them in the course of their overseas operations. Gradually, the practice developed whereby the larger concerns consulted

the Bank or the Treasury over transactions of this sort which were calculated to involve a large transfer of funds. But right up to 1939 there was no legal control: nor was there anything to prevent shares or bonds issued overseas from being brought to this country and re-sold here, so as to involve the export of the money needed to pay for them.

In effect, the British capital market of pre-war years was in a fairly chaotic condition, though during the 'thirties the Bank and the Treasury had been gradually tightening their control over foreign issues, and the abuses in connection with home issues had decreased, partly as a result of the new checks but much more because the total volume of issues had fallen off and there was much less prospect of speculative gains.

It should be observed at this point that such controls as did exist over the long-term capital market were almost exclusively *financial*, and had practically nothing to do with the adjustment of the supply of capital for different purposes to social or economic needs. It was nobody's business to consider how much capital was needed for this or that industry as a whole (unless the industry was fully integrated in the hands of a single great concern, such as I.C.I.), or whether capital was flowing in the quantities needed to different areas, or whether the demands for capital that were being put up in the capital market were complementary, or conflicting. It was nobody's business to consider whether the *total* demand for new capital for investment was equal to, or less than, or greater than, the supply of savings available; and it was hardly anybody's business to protect the interests even of the shareholders beyond the rudimentary precautions against fraud which have already been described.

The shareholders did, however, enjoy some further protection, whereas the general body of the public had none—no assurance, that is, that the course of investment would be in any way related to the real needs of the country. The investor's further protection came through the special agencies described earlier—Investment Trusts, Fixed Trusts, and similar bodies—which exist primarily for the purpose of 'spreading' risks, but can be used also to a certain extent for reducing them. The Investment Trusts, or rather some of them, are considerable buyers of the more promising new issues; and as they buy to hold as well as to re-sell, they take an interest well beyond the short visions of the stock market speculators in the prospects of the companies in which they hold shares. They have often been in a position, by threatening trouble at shareholders'

meetings or through City 'talk', to bring pressure to bear on concerns which they have suspected of fraud or gross mismanagement; and their increasing importance as factors in the investment market between the wars added greatly to their influence. They too, however, are moved by purely financial considerations: it is no part of their business to try to place their shareholders' money with any other view than the maximum profit consistent with reasonable security for the sums invested.

The question that arises is whether there ought to be some general *planning* of investment, not from the financial standpoint only, but also from that of the right use of capital in promoting a high level of production and employment, rightly balanced between different branches of production and service, and between different areas. Clearly, the private investor cannot be expected to concern himself greatly with this; and no more can be looked for from investment agencies which are run for the purpose of securing the maximum profit, and have no interest in what is done with the money invested, beyond their interest in the profit to which it is likely to lead. It would be Utopian to expect more than a very limited number of investors to put their money into, say, model public-houses at 4 per cent., if they believed, even erroneously, that they could get 8 per cent. out of tracks for greyhound-racing. Local Authorities and Public Corporations, when they issue appeals for capital, may be presumed to make them in some relation to the real needs of the areas and services concerned; and of course those who make appeals for capital for profit-making industries expect to find a demand for the products which the capital will be used to make. If the supply and demand forces worked out with the beautiful harmony which can be attributed to them in textbooks of economics, the profit-expectations of business men would induce them to apply for just as much capital as they could employ to the maximum advantage of the whole body of consumers in their several branches of production, and there would be no need for investment to be in any way planned. But no one in his senses will contend that the forces of supply and demand do work themselves out in this socially beneficent way; or, at all events, anyone who does can be sufficiently confuted by the history of the new investments made during any boom period. It is a plain fact that a large part of the capital invested at such periods—when the majority of new capital investments are made—loses a considerable fraction of its value within a very few years. The waste of invested money through the market for new

capital issues is quite appalling *; and although it is, of course, to be noted that the capital goods remain for the most part in being, even if their money value falls, this is no defence, for the fall in money value is at any rate some indication that the capital has been misapplied. There is probably a good deal less misapplication of capital invested out of company reserves; for the directors of going concerns are more likely to be interested in permanent, rather than in merely speculative, values, and have a better chance of estimating correctly the possibilities of market demand. Yet experience has shown that they too can make colossal blunders, especially in buying up competitive businesses at grossly inflated prices, as happened after 1918, and in branching out into subsidiary activities which require quite different techniques from those in which they are expert—as occurred in the case of Lever Bros. at the same period.

No doubt, capital losses in connection with new investments would be very much smaller than they are if total demand were less unstable. If the State were to assume an effective responsibility for the maintenance of full employment, business men would be able to embark on investment in capital goods with a much better assurance of finding markets than they can have under conditions of unstable economic activity. Indeed, this is what they have been able to do since 1945, under conditions of full employment accompanied by shortage of capital goods, which has involved cutting out many of the more speculative investments and concentrating largely on those for which the prospects of success have been high. When *total* investment is planned and held firmly at a planned level, particular processes of investment can to a much greater extent be safely left to look after themselves, outside the field of 'public works' and other forms of public or publicly controlled investment. But this is only to say that if a large part of the total investment were consciously planned under public auspices, much less harm would be done by leaving the uncontrolled margin unplanned. It does not follow that it would not be better for the community for a large part of private investment to be planned as well, from the standpoint of the community's needs as well as from that of the investors' prospects of profit.

The proposal most often put forward for the planning of investment in Great Britain—I shall have something to say about international investment in a later chapter—has been that there should be

* See, for example, the facts cited in *Studies in Capital and Investment* (ed. G. D. H. Cole) about the new issue boom of 1928, and also the Macmillan Report.

created some sort of National Investment Board under the auspices of the State. This proposal has taken many different forms. At its most modest, it has envisaged no more than a co-ordination under the auspices of a single body of supervision over all the investment done by public bodies—the State, the local authorities, and the various public and semi-public corporations and boards subject to government or local government control. Such investment already covered, in the decade before the war, a very substantial fraction of the total new capital applied to economic and social development. Public buildings, schools, municipally built houses, hospitals, roads, waterworks, gas and electrical construction under public bodies, publicly run transport services, docks and harbours, naval ship-building, postal extensions, afforestation under the Forestry Commission, and other public or publicly controlled capital works took up a large proportion of the total capital applied to home development; and if one adds to these railways and forms of industrial enterprise specially subject to the influence of government policies (e.g. the steel industry and various branches of agricultural processing such as bacon and beet-sugar production), the proportion was, of course, much larger still. Large, however, as government influence on capital development was, this influence was not exerted in any co-ordinated way, or in the light of any general, publicly sponsored investment plan. One object of the protagonists of the idea of a National Investment Board was to bring about a co-ordinated review of all these forms of capital expenditure, and a timing of them designed to adjust their total volume to the needs of the community, both by establishing a balanced order of priorities and by varying public capital expenditure in such a way as to offset the fluctuations in private investment.

Some of the advocates of a National Investment Board have gone a long way beyond this, and have wished the Board to have the additional function of licensing, or refusing to license, private applications for capital through the new issue market, so as both to affect the total amount and the timing of such issues and to sift proposed issues from the standpoint of their public usefulness. In some cases, the emphasis has been put mainly on regulating the total volume of issues or on cutting out those which appeared to be unwarranted from the standpoint of social needs: in others, it has been stressed that control over new issues will enable the State to prevent the piling up of new factories and extensions in already congested areas and to encourage new enterprises to settle in depressed areas in

TABLE XX

STATISTICS OF BRITISH SAVINGS AGENCIES AND PUBLIC INSURANCE FUNDS, 1913 AND 1938-1953

	Post Office Savings Bank Deposits (U.K.) £ *Mn.*	*Trustee Savings Banks Deposits (U.K.)* £ *Mn.*	*Savings Certificates Outstanding: excluding Accrued Interest* * £ *Mn.*	*Unemployment Insurance Fund Balance* † £ *Mn.*	*Health Insurance Funds Balance (U.K.)* £ *Mn.*	*Contributory Pensions Funds Balance*† *(U.K.)* £ *Mn.*
1913	187	54	—	—	—	—
1938	509	238	386	42	144	22
1939	551	251	381	43	147	25
1940	652	279	431	27	149	30
1941	823	327	603	33	156	40
1942	1,005	381	831	103	166	52
1943	1,075	400	1,034	177	171	65
1944	1,317	475	1,292	252	174	78
1945	1,580	555	1,511	323	176	90
1946	1,876	626	1,604	396	180	100
1947	1,982	696	1,673	454	179	114
1948	1,970	764	1,741	525	175	123
1949	1,949	853	1,719		1,017 ‡	
1950	1,936	902	1,680		1,180 ‡	
1951	1,875	924	1,721		1,348 ‡	
1952	1,813	936	1,731			
1953	1,747	955	1,761			

* Accrued interest was £524 millions in March 1953.
† Figures for financial years ending in March of the year given.
‡ Combined Resources of National Insurance and Industrial Injuries Funds.

TABLE XXI

Co-operative Societies, 1913 and 1938-1952

	Retail Societies			*Wholesale Societies*	
	Members Thousands	*Funds £ Millions*	*Sales £ Millions*	*Funds £ Millions*	*Sales £ Millions*
1913	2,878	46	85	12	40
1938	8,405	200	263	108	154
1939	8,643	215	272	111	156
1940	8,717	214	299	108	173
1941	8,773	225	302	120	177
1942	8,925	246	319	138	193
1943	9,082	274	332	164	203
1944	9,225	302	352	192	223
1945	9,405	326	361	209	224
1946	9,730	343	402	227	252
1947	9,977	350	444	222	276
1948	10,162	351	503	208	311
1949	10,414	349	549	189	359
1950	10,692	345	614	174	394
1951	10,929	340	664	148	439
1952	11,093	338	720	143	506

which there is a surplus of labour which the existing enterprises cannot absorb. Many of the advocates of a National Investment Board argue, further, that its control should extend to investment made out of company reserves as well as to new capital issues, and that investment control should be reinforced by a permanent system of licensing directly applied to new industrial building and use of land under an amended Town and Country Planning Act. That is to say, the control of investment has been thought of, not merely as an instrument for regulating the total flow of new capital into economic development or of bringing about a better balance between the sums directed to the various industries and services, but also as a means of achieving an improved distribution of industry and population over the country as a whole and, more particularly, of helping depressed areas to recover their prosperity.

It is not easy, having gone so far, to stop at this point. It has been argued, with some force, that, if business men are severely checked

from promoting industrial investments when and where they please and in such branches of production as they deem likely to offer the largest return, the effect will be to depress the total volume of private investment. Accordingly, to some it has seemed necessary to advance a stage further, and to propose that the National Investment Board should not merely *control* capital development, but also promote it in a positive sense. In order to do this, the Board would clearly need to have capital of its own to invest in enterprises of which it approved. It has therefore been suggested that the Board should be given power both to guarantee over a period of years the return on approved investments in new capital development and to borrow money from the public at a fixed rate of interest and re-invest such money in such capital projects as it deems worthy of special encouragement on public grounds.

There are precedents, on a limited scale, for action along both these lines. After the first World War the State, under the Trade Facilities Act, was able to guarantee the return on approved projects of capital construction; and the extensions of the London Tubes in the 1920s were actually carried through under this arrangement, while later railway developments were stimulated in somewhat similar ways by the creation of special 'Treasury Companies' to supply the funds. Moreover, the State, in attempting to cope with the special problems of the depressed areas in the 1930s, was led to confer on the Special Commissioners for these areas powers which enabled them to apply public money to fostering capital development. At the outset, these powers were limited to non-profit-making forms of enterprise, but later this ban was removed, after the way had been pioneered by the Nuffield Trust—a private agency set up to make advances of capital to businesses willing to locate their factories in depressed areas. The Trading Estates set up in the 1930s in South Wales, in the West of Scotland, and on the North-East Coast were similarly designed to encourage capital investment in areas in which there was a clear need for additional employment openings.

It is true that all these measures were on a small scale, and that the proposal to set up a National Investment Board, empowered to raise money from the public and to re-invest it in approved enterprises to be run for profit, goes a long way beyond anything that was done before 1939. The advocates of such a Board argue that the State ought to assume the responsibility for maintaining full employment, and that, as nationalization is unlikely to be extended in the

near future beyond a limited range of key industries and services, it follows that the State ought to interest itself in the employment-giving capacity of a wide range of industries which are under private ownership and control. They argue that a National Investment Board, with power to raise money by loan and to re-invest in non-nationalized forms of enterprise, would give the State a greatly enlarged power to influence the course of investment, from the double standpoint of ensuring its adequacy in total volume and its right distribution between industries and areas in accordance with social needs.

The setting up of a National Investment Board of this type would, of course, involve that the State would become the partner of private enterprise in many fields of business, and the part-owner of many factories run on commercial lines with a view to profit. This kind of mixed enterprise has been experimented in much more widely in other countries than in Great Britain; but it is not without precedent here. The British Dyestuffs Corporation, subsequently merged in I.C.I., was in its inception a mixed enterprise, in which the State and private capital were partners; and the Anglo-Iranian Oil Company is an existing example of government investment in a big capitalist enterprise. There is nothing startlingly novel, then, in the idea of such partnership: what is novel is the idea of extending it widely, to small as well as large enterprises, and of applying it where no special grounds of national 'security' can be advanced.

The Labour Government of 1945 lost no time in making certain tentative advances in the direction of public control over investment. Its Act dealing with industrial location and development embodied —though only for certain districts scheduled as 'Development Areas'—definite provisions for the establishment of new Industrial Trading Estates; and special agencies were set up to help with the provision of capital for firms willing to settle in these areas. In addition, the control of building made it in effect impossible for firms to put up new factories, or substantially to enlarge existing factories, except in locations approved by the Board of Trade; and such areas as South Wales, West Cumberland, and South Durham found themselves reinforced by the advent of considerable numbers of factories employing mainly female labour—for which there had been in these old centres of the heavy industries an exceptionally low demand. The disposal of war factories belonging to the Government was also managed in such a way as to encourage a balanced

growth of industry in places where a serious danger of unemployment or under-development appeared to exist.

In addition, in 1945 the Government established two new companies, with the purpose of aiding in the provision of capital for new or expanding industrial undertakings—the one to deal with large, and the other with relatively small, concerns. The idea behind these new 'Treasury Companies' was to fill a gap in the existing capital market, especially by making it easier for new types of industry and for concerns of relatively small size to get capital without incurring unduly heavy financial and underwriting charges.

When, however, the Government proceeded to introduce its plans for the direct control of investment on the financial side, it was seen that it was minded to go only a very little way towards the creation of the kind of Investment Board that it had seemed to favour in its earlier programmes. The Act of 1946 in effect made permanent the wartime control exercised by the Capital Issues Committee of the Treasury. This Committee, or rather the Treasury acting on its advice, was given permanent power to regulate capital borrowing (except borrowing from a bank), the issue of new securities, including capitalization of reserves and new issues arising out of company amalgamations, and the operations of Unit Trusts. Transactions by existing companies, except in respect of bonus shares, involving less than £50,000 in one year were exempted from control; but new companies came under the regulation irrespective of size, unless they were specially exempted. Thus the restrictive powers went a long way; but there was in the Act little sign of any constructive approach to the positive planning of investment policy. The only really constructive clause was that which authorized the Treasury to guarantee, up to a limit of £50 millions in any one year, the interest and principal of loans for industrial reconstruction and development. No National Investment Board was set up, with the function of planning the main investment programme of the country in real terms of plant and productive capacity, or of supplying as well as merely guaranteeing capital for urgent national tasks. The Act was only a minor measure, designed to regulate new issues and prevent obvious abuses: it was in no sense a fulfilment of the policy of planned investment which had been widely advocated in Socialist quarters for many years before 1945.

Nor had the Planning Board which was presently established within the Civil Service any such functions. It was hardly more than an advisory committee designed to ensure that the policies of

the various government departments concerned with economic control and development did not clash.

There was, nevertheless, after 1945 a considerable approach to the planning of investment, at least in a negative sense. The annual Economic Surveys which the Government presented to Parliament were in no sense development or production plans analogous to the Five Year Plans of the Soviet Union. They were no more than intelligent forecasts of what was likely to occur on the basis of existing trends. They were, however, drawn up in the light of the Chancellor of the Exchequer's conclusions, in view of the prospect of national income, overseas trade, and other relevant factors, concerning the amounts which could be devoted, during the ensuing year, to consumption and to investment, including the financing of public expenditure on government, social services, armaments, and so on. They thus included assumptions concerning the total sum which the community could afford to invest during the year, and a broad indication of the directions in which it should flow. Moreover, whereas up to 1939 the Budget was regarded simply as an instrument for raising the money which the Government intended to spend, after 1945 it acquired a second function—that of raising by means of taxation a surplus designed to reduce the spendable incomes accruing to private persons and agencies to a level corresponding to the supplies of goods and services expected to be available and to the prices at which they were expected to be sold. In other words, a budget surplus became an instrument for countering inflationary tendencies in the economy, the surplus being used for reducing the outstanding volume of public debt, or for covering new public capital expenditure.

At the same time, it was necessary to exercise a strong control over capital movements out of the country—that is, over investment abroad at either long or short term—both in order to prevent the flight of capital seeking escape from high taxation or government control, and in order to reduce the pressure on the foreign exchanges from attempts to invest abroad even for normally legitimate purposes.

Such control was unavoidable in view of the pressure on the balance of payments. But it was necessary, after 1945, to control, not only overseas investment, but home investment as well. Many business men wanted to modernize or expand their factories or to build new ones, in view both of the good prospects of profit and of the arrears of maintenance and development that had piled up during

the years of war. There was also an active demand for the building of new places of entertainment, blocks of offices and flats, hotels and restaurants, and other commercial structures, partly to replace war damage and partly to provide for growing needs. There was an urgent need for more houses, as well as for schools and other public buildings. The coal, electricity and steel industries required large capital expenditure; and so did the railways and roads. All these demands—and many besides—could not be met at once in view of the limited total productive resources; and it was necessary to assign priorities and to postpone developments that were regarded as less urgent than others. Housing, in view of the high priority assigned to it by a large body of public opinion, as well as of the evident urgency of the need, was bound to absorb a great proportion of the available resources of the building industry; and many of the other demands also pressed heavily on building capacity, which could not be rapidly expanded without coming up against other limits, such as the shortage of timber and other essential materials. It was necessary in these circumstances (*a*) to limit total investment to what could be spared out of current production; (*b*) to restrict overseas investment on account of balance of payments difficulties, and in order to prevent a flight of capital; (*c*) to choose between alternative home investments, in relation both to the urgency of different needs and to the availability of materials, suitable man-power, and other productive resources; and (*d*) to take special measures to stimulate exports, both directly and by ensuring that firms producing for export should get a large share both of necessary man-power and materials and of capital goods which would enable them to improve their efficiency and thus compete more advantageously in overseas markets, particularly where dollars could be earned.

The controls needed for these purposes, as far as home investment was concerned, were not primarily monetary, though every project had its monetary aspect. The control of total, and of foreign, investment was, however, primarily a monetary matter. Total investment had to be controlled both by budgetary policy and by the manipulation of bank credit, and also by the licensing of capital issues. Overseas investment had to be more rigidly held down, especially as it was necessary to provide resources, despite the adverse balance of payments, for colonial development and also for those Dominions and other sterling area countries which had been accustomed to look to Great Britain as a main source of capital. Moreover, it was necessary to provide for gradual repayment of the large sterling

balances which had been piled up during the war to the credit of India and Egypt and certain other countries. As we have seen, this could not have been done without help from the United States; and in practice the sums received as Marshall Aid were passed on as either gifts or investments, or repayments of sterling balances, to overseas countries. But even with aid from America the necessity of strong controls remained. After 1945 London ceased to be a market in which capital could be borrowed except by those who had very special claims.

When re-armament set in, and especially after the Korean crisis, the cost of armaments became directly competitive with that of capital equipment; and the expanded arms programme reacted so seriously on what could be spared for investment, even at home, that it had to be modified by being spread over a longer period than had been intended. The clash between re-armament and capital development is a matter, not only of limited total resources, but also of direct competition for the use of the same kinds of specialized equipment and man-power. Armaments are, moreover, directly competitive in the same way with exports; for the exports it is easiest to expand consist of capital goods produced by the same types of productive resources as arms and goods needed for home investment.

All this meant that after 1945 the Government, whether it wished to or not, had to exercise a strong control over investment both by monetary action and by more direct methods. This, however, was by no means easy; for the biggest source of funds for investment, except in houses, consisted of the reserves of free capital in the hands of business firms, which could use them for development projects without going to the capital market for funds and were accordingly not affected by the control imposed on new issues of capital. The use of these reserves for home investment could be controlled only by withholding building licences or supplies of materials, or in the last resort, access to man-power, to firms which could not persuade the government departments concerned that their projects had high claims in the public interest; and these forms of control became less effective with time, as some of the physical shortages of material came to be less severe. Businesses gradually regained the power to invest their reserves in new capital goods more as they pleased, subject only to continued restrictions on their power to import machinery from abroad. As this happened, the control over new capital issues was also to some extent relaxed, and capital reconstruc-

tions were also more freely allowed. Except in relation to overseas investment and to the import of capital goods the capital market began to resume some of its pre-war characteristics, with the difference that it was no longer, for the time being, a matter of stimulating total investment in order to bring unemployed resources into use, but rather one of preventing excessive claims on the capital market and on the industries producing capital goods.

There was, of course, also the difference that the State, as a consequence of the socialization of a number of industries and services and of the preponderance of public activity in housing, had come to be a much larger investor than it had been in the 1930s. The capital needed for the development of coal, electricity, gas, transport, civil aviation, and, for a time, steel, was raised by Public Corporations and not by private firms; and the buildings needed for the health and education services, as well as for housing, were paid for out of capital funds raised by local public authorities. Some of this capital was raised by means of state-guaranteed, or local-authority guaranteed, borrowing, and some by Public Corporations acting without formal public guarantee. In either case, the public authorities were competing in the capital market with private borrowers; and the terms on which they were able to borrow depended on the total supply of money available for investment, which in turn depended on the budgetary and monetary policies followed by the State and the socialized Central Bank. In the absence of a specialized National Investment Board, this meant that the final control of the whole process rested with the Treasury, but that, outside the socialized sector, the initiative in capital development remained with private business, subject to a mainly negative control exercised through the various government agencies concerned with giving licences or permissions and through the Capital Issues Committee and the banks. The State did indeed provide, or help to provide, capital for certain kinds of development which were regarded as of special national importance, both through the new Treasury Companies formed with this object and by developing Trading Estates and other special projects. But there was no move towards any general practice of public investment in 'mixed' concerns based on partnership between the State and private business.

For my part, I have held for many years that there is much to be said in favour of actual partnership between the State and private enterprise in the ownership of industrial concerns. Complete public ownership, of the type so far adopted for the great basic industries

and services, and municipal ownership are both unsuitable for the general run of manufacturing industries, in which there is great diversity of products and businesses are of every sort and size. I can see no objection at all to public and private enterprise existing side by side in these fields,* or to the emergence of a type of business which is neither public nor private, but mixed. Of course, such mixed enterprises could not be subjected to the traditional forms of civil service control; but who, nowadays, thinks that any industry, however completely it ought to be 'nationalized', can appropriately be run by civil service methods? Such bodies as the Central Electricity Board and the London Passenger Transport Board in the 1930s, and the National Coal Board and the similar Boards for other socialized industries and services set up since 1945, are experiments in the technique of running socialized services without civil service forms of administration. Why should there not be further experiments of a different kind—publicly appointed directors sitting side by side with privately appointed directors to control the affairs of 'mixed' concerns? Such experiments have worked well in other countries—for example, in Sweden, as well as in pre-Nazi Germany. Why should they not be tried out here?

Why, for example, should not insurance funds—if the Insurance Companies are brought, as they should be, under public control—be used for public investment in 'mixed' concerns? The Insurance Companies are very large investors—so large that their investment policy produces a considerable effect on the development of the industries and trades to which they direct their attention. Why should not the National Investment Board, the Investment Trusts, the Building Societies, and the Insurance Companies be taken over as Public Corporations and used as the instruments of a concerted plan of investment, designed to fulfil the requirements of a national policy of full employment?

Such a policy would no doubt call for the establishment, not only of a powerful National Investment Board, but also, under it, of a number of more specialized agencies dealing with particular industries or groups of industries. If the State became a shareholding partner in a number of mixed enterprises, it would have to build up *cadres* of directors to represent it in their affairs. These directors would need to follow a common policy and to be related to the National Investment Board through some special subsidiary con-

* This was actually the position under the Steel Nationalization Act passed by the Labour Government, but repealed by its Conservative successor.

cerned with the general planning of investment in each industry or group. They would have to work under the general directions of the National Investment Board and to advise it about the best ways of applying its policy in each particular field in relation to the plan of economic activity, so it also involves a planned application of long-term capital—a right amount of capital projects, public and private, to absorb the national 'savings', and an appropriate distribution of the outlets for capital among the different forms of economic development. The more the State can influence the course of private investment the less will it have to do either in the way of emergency public works designed to fill up a threatened gap between 'savings' and investment or, in a contrary sense, to check a speculative investment boom. It will be possible to settle the relative places of public and private enterprise on grounds of national expediency, instead of having either to improvise public works for the purpose of preventing mass-unemployment or to damp down desirable as well as undesirable investment by purely monetary restrictions.

Had I been writing this chapter a dozen years ago, I should have felt certain of being heavily fired at by dogmatic Socialists, who would have argued against me that public and private enterprise could never join hands, as well as by dogmatic anti-Socialists who would have reached the same conclusion from diametrically opposite premises. Indeed, I did write something very like it as long ago as 1929, and I was fired at from both these angles.* No doubt, I shall be fired at now—but less perhaps in the spirit of absolutist dogma. There are many more non-Socialists now who admit the need for extensive state action in the economic field; and there are very few Socialists who really want to apply the formula which advocates 'the nationalization of the means of production, distribution, and exchange' to every kind of business, large or small. There is plenty left to differ about; but the grounds of difference have shifted, and it is now rather a question of *what* to socialize, and how, and what to leave in private hands, than a question whether we should socialize all or nothing.†

It is true enough that, given the definitive acceptance of full employment as the objective of public economic policy, the market for both consumers' goods and capital goods would be much better

* See *The Next Ten Years in British Social and Economic Policy* (Macmillan, 1929).

† See *A Word on the Future to British Socialists*, published by the Fabian Society in 1942, and also my own book, *Fabian Socialism* (Allen & Unwin, 1943), for a fuller discussion of this issue.

assured than it has been, and that, the risks attendant on private investment being thus reduced, there would probably be much less sheer waste involved in unregulated private investment. Less waste, that is to say, from the standpoint of the investor; but there might still be grave waste and misdirection from the standpoint of the community as a whole. From the standpoint of the community, it is desirable not merely to prevent capital from being frittered unprofitably away, or to ensure full employment, but also to promote the use of both capital and man-power in such ways as will achieve the maximum of social welfare, and prevent decay and destitution in some areas from co-existing with prosperity and progress in others. The right use of capital and of man-power is a social, as well as a chrematistic, question: it is a matter of the happiness of the people, and not merely of the investors' profit. Moreover, it may well be that the social problem of the future will continue to be not an excess of man-power, but a shortage. Under such conditions, it will be vital to our standards of living to ensure that what man-power we have is used in the most socially productive ways; and the only method of achieving this without resorting to the direction of labour, which is clearly undesirable in the interests of human freedom, will be to exercise a well-planned control over the investment of capital, so as to create a highly productive economic system within which individual liberty can be reconciled with the direction of output in accordance with social needs.

XII

INTERNATIONAL TRADE AND THE GOLD STANDARD

THE essential difference between home and foreign trade is that, whereas in home trade both parties to the transaction use the same sort of money, in foreign trade they use different sorts. Each seller usually wants to be paid in his own country's money*: each buyer would usually sooner pay, if he could, in his own country's. In fact, the buyer can only pay in the money of another country if he can get such money in exchange for his own. Foreign trade, therefore, involves arrangements for exchanging one sort of money for another; and, as buyers want to know how much they will have to pay in their own national money, this involves, if there is to be any security for trade, reasonable stability, at any rate over short periods, in the rates at which different sorts of money can be exchanged.

The gold standard is a method by which the value of a national currency is fixed in terms of gold, and has therefore a practically fixed value in relation to the currencies of other gold standard countries, though not, of course, to those of countries which are not under the gold standard.† Even between gold standard countries relative currency values are not quite fixed; for it costs something to transport gold from one country to another, and the exchanges can fluctuate within the limits set by the 'gold points'—that is, in either direction up to the point set by the cost of transporting gold. This cost is so small that the 'gold points' are quite close together, and no trader is likely to be much put out in his calculations by exchange fluctuations confined within these limits. The gold standard, therefore, has considerable advantages as affording a stable basis for international trade.

The gold standard, of course, involves not merely that a country shall *say* its money is worth so much gold, of a certain standard

* Or in some money that can be freely exchanged into it. Of course, where firms operate in more than one country, it may suit them best to be paid for particular sales in the currency of any country in which they are incurring expenses; and when a particular currency is scarce many firms will prefer to be paid in it, but in such cases will usually be required by their own Government to hand over their dollar or similar receipts and take national money in exchange.

† Or under some other standard which has a similar effect.

fineness, but also that its money shall actually *be* worth this amount. Accordingly, there must be some place to which anyone, or at all events anyone with payments to make in gold standard foreign money, can go and get either the money he wants at a nearly fixed rate of exchange for his own money, or actual gold. In effect, the Central Bank of the country concerned must be prepared either to pay out gold on demand at the fixed rate, or to supply on nearly fixed terms unlimited quantities of any gold standard foreign currency for which it is asked, at all events for any legitimate purpose. It need not, for the purposes of foreign trade, be prepared to pay gold if it is ready to supply any quantity of any gold standard foreign money that is asked for, at a rate within the 'gold points'.* But its power to do this will depend on the possession of a gold reserve of its own which it can use to replenish its supplies of any gold standard currency of which it may run short.

In the terms of this definition, Nazi Germany in the 'thirties was not on the gold standard, even though the *reichsmark* was supposed to represent a fixed value in gold. Germany was working under a system of rigid 'exchange control' which denied both to German nationals and to foreigners any *right* to convert their holdings of German money into either foreign exchange or gold. Gold could not be got at all; and foreign money could be got only for purposes and in amounts approved by the State. There were, in practice, at the Reichsbank many 'blocked' accounts in *reichsmarks*, belonging to people who would have liked to change them into other currencies but were not allowed to do so—with the consequence that these 'blocked' *reichsmarks* were bought and sold for much less than their face value. Similarly, there were many German traders who would have liked to buy goods abroad for sale in Germany, but were not allowed the means of paying for them in foreign currency. There were also at the Reichsbank special accounts into which German importers had to pay in *reichsmarks* the sums they owed to foreigners,

* It is also possible for a Central Bank, by fixing two prices—one at which it is always ready to sell, and the other at which it is always ready to buy gold in exchange for the national money—to allow for somewhat greater fluctuations than are possible when its buying and selling prices are the same. Under this system, the gold value of the national money can fluctuate by the amount of the difference between the buying and selling points, and the taking of gold out of the country is discouraged. The effect is to impose a small tax on the purchase of gold. This system cannot of course prevail against a run on gold based on fears of devaluation: all it does is to discourage speculative movements of gold from one country to another.

and out of which German exporters received in *reichsmarks* payment for goods sold abroad. These accounts were flanked by similar accounts in the Central Banks of other countries with which Germany had 'clearing' agreements; and no one who sent goods to Germany could get paid unless the account in the Central Bank of his own country had enough funds in it to pay him. If trade between Germany and the other country balanced, everyone concerned got paid in his own money. If not, surpluses piled up in one Central Bank, and in the other there was a deficit, so that exporters from that country had to wait for their money, unless there was a State Exports Guarantee Department, as there was in Great Britain, in which they could insure for payment of part of the sums due.

There have been, since 1945, a good many clearing arrangements and other devices which are reminiscent of what the Nazis practised during the 1930s. Indeed, such measures have been forced on many countries which have found themselves in exchange difficulties; and in some cases they have been adopted quite deliberately for the purpose of 'bilking' foreign creditors. Sometimes they have been discreditable, as in the case of the Argentine's arbitrary methods of fixing discriminative currency values to suit its own ends; but in many cases they have served to keep trade moving where it would have been paralysed without them. There is nothing inherently wrong in clearing agreements, when the situation requires them: they become wrong when they are used to benefit one party at another's expense rather than to make trade possible in the interests of both parties.

Before the war, a good many countries, instead of attempting to keep large gold reserves of their own, met the needs of their traders by holding large sums in foreign exchange—that is, either directly in the currencies of other countries or in short-dated obligations, such as bills, which they could quickly convert into these currencies. This meant that the leading gold standard countries commonly had the use of considerable sums of money belonging to the nationals of other countries, or to their Central Banks, and might at any time have to pay out this money either in their own currencies, or in other currencies, or in gold, if the owning countries wanted it back. The advantage of this system, from the standpoint of the countries which held their reserves largely in foreign exchange, was that their money deposited in other countries usually earned them something in interest, whereas gold locked up in their vaults would have earned nothing. From the standpoint of the country which held these

balances, it was supposed to be an advantage to have the use of the money; but it was necessary for their Central Banks * to hold larger gold reserves than would otherwise have been needed, in order to meet demands for repayment when the depositing countries wanted, not the currency of the country in which the funds had been lying, but some other, of which its Central Bank might not have a sufficient supply. The method followed by countries which held a large part of their reserves in foreign exchange was known as the 'Gold Exchange Standard', and it was a perfectly satisfactory substitute for the gold standard proper on the assumption that the countries in which they kept their funds could be relied on to maintain the gold standard in its integrity. When Great Britain went off the gold standard in 1931, countries which had kept their reserves wholly or in part in Great Britain suffered losses in the gold value of these reserves, and were in most cases impelled to devalue their own currencies by at least as much as the British currency fell in value.

We have seen that the outstanding advantage of the gold standard is that it facilitates stable bargains in international trade. In any transaction made between traders in two gold standard countries, both buyer and seller know within very narrow limits what they will have to pay and to receive in their own money. Moreover, there is a tendency for countries working under the gold standard in its integrity to be enabled to undertake the financing not only of their own trade, but also of trade between other countries. Payment in a currency convertible into gold at a practically fixed rate is likely to be acceptable anywhere; and, in the old days, bills drawn on London had a world-wide currency.

There are, however, disadvantages in the gold standard, even from the standpoint of international trade. A country which is working under the gold standard must keep its level of prices, at all events for goods which it wishes to sell abroad, and (subject to tariff or other barriers) for goods which its own nationals can import as substitutes for home products, at a point that will not make such goods dearer, quality for quality, than goods produced in other countries. If it fails to do this, it will lose its export trade, and will be unable to pay for the imports it needs. If no restriction is placed on imports, it will then lose its supplies of foreign exchange and of gold in paying for them, and will in the end be driven off the gold standard. It may sound quite reasonable that a country be required to keep its selling prices for exports in balance with prices in other

* Or Exchange Equalization Funds, where they had been set up.

parts of the world; but this means that, if in a particular country which is big enough to be an important factor in world trade there occurs a serious slump and prices are driven down sharply, other gold standard countries will be forced to make corresponding price-reductions, even if this leads to widespread losses and mass-unemployment. As long as all the great gold standard countries proceed on a basis of continuous full employment, all is well. But as soon as there is a serious slump in one of them, it is practically bound to spread to all the others.

This is a particularly serious question for Great Britain. The United States has so vast a gold reserve and has shown so marked a tendency in recent years for its exports to exceed its imports as to be an exception to the rule that adhesion to the gold standard must mean internal slump and deflation should economic affairs go wrong in other parts of the world. It is difficult to imagine, for a long time ahead, a situation in which the United States, whatever its internal policy might be, would run short of the means of making foreign payments. The most that could happen even as the consequence of a serious slump in American foreign trade would be a fall in imports, a cessation of net foreign investment, and some drawing upon the vast accumulations of monetary gold at present locked up in American possession. No doubt, if the drain continued for a very long time, even America's strong creditor position could be overset; but for practical purposes such a contingency can be ruled out in considering present policy. The United States has so much gold that it need fear, from a monetary point of view, neither a foreign drain nor any lack of ability to finance any internal currency and credit expansion that may be needed without altering either the gold parity of the dollar or the laws regulating the supply of credit. The Americans might, no doubt, *wish* to go off gold or to change the gold value of the dollar for some other reason, as they did in the 'thirties; but they could hardly be driven to any such course by lack of gold or foreign exchange.

With Great Britain the situation is bound to be very different; for Great Britain has now no large stock of gold, and since the war it has always been difficult, even under highly favourable conditions in the world market, to raise exports to the level needed both to pay for imports on the scale requisite for full employment at a satisfactory standard of life and to meet the payments due on debts incurred to overseas countries either during the war or since. Indeed, most European countries have found themselves in a similar diffi-

culty. If Great Britain, or any country similarly circumstanced, were to return to the gold standard at a parity corresponding to

TABLE XXII

Foreign Trade of the United States and of the United Kingdom, 1928–1953

	U.S.A. *Millions of Dollars*				U.K. *£ Millions*		
	Imports	*Exports*	*Difference*	*Gold Imports*	*Imports*	*Exports*	*Difference*
1928	7,043	8,831	+1,788	—	1,196	844	— 352
1929	7,557	9,015	+1,458	—	1,221	839	— 382
1930	5,255	6,599	+1,344	—	1,044	658	— 386
1931	3,588	4,150	+ 562	—	861	454	— 407
1932	1,342	1,625	+ 283	— 447	702	416	— 286
1933	1,510	1,694	+ 184	— 174	675	417	— 258
1934	1,758	2,149	+ 391	+1,134	721	447	— 274
1935	2,402	2,302	— 100	+1,739	756	481	— 275
1936	2,605	2,468	— 137	+1,116	848	501	— 347
1937	3,176	3,361	+ 185	+1,568	1,028	597	— 431
1938	2,191	3,102	+ 911	+1,973	920	533	— 387
1939	2,403	3,192	+ 789	+3,574	886	486	— 400
1940	2,684	4,025	+1,341	+4,744	1,152	437	— 715
1941	3,392	5,153	+1,761	+ 982	1,145	378	— 767
1942	2,797	8,081	+5,284	+ 316	997	276	— 721
1943	3,409	12,996	+9,587	+ 69	1,234	239	— 995
1944	3,952	14,386	+10,434	— 845	1,309	282	— 1,027
1945	4,186	9,897	+5,711	— 106	1,104	450	— 654
1946	4,997	9,775	+4,778	+ 312	1,301	965	— 336
1947	5,824	15,369	+9,545	+1,867	1,794	1,198	— 596
1948	7,195	12,665	+5,470	+1,680	2,078	1,646	— 432
1949	6,698	12,074	+5,376	+ 686	2,275	1,844	— 431
1950	8,962	10,281	+1,319	— 371	2,608	2,256	— 352
1951	11,070	15,038	+3,968	— 549	3,914	2,707	— 1,207
1952	10,785	15,196	+4,411	+ 684	3,478	2,728	— 750
1953	10,966	15,768	+4,802	+ 2	3,344	2,688	— 656

actual rates of exchange prevailing at the moment of return—that is, broadly speaking, if the gold values of the various currencies were fixed in relation to their several external purchasing powers at a definite date—the effect would be to tie the future course of

economic affairs in Great Britain, or in any other country bound in the same way, to the course of fluctuations in the United States, without any corresponding necessity for the United States to be influenced by events elsewhere.

This is a very serious matter; for, as we have seen, the economic system of the United States has shown itself hitherto the most unstable in the world. Dependent to a much smaller extent than Great Britain on international trade—for a much higher proportion of American output is consumed at home—the United States has suffered from a prodigious internal instability. At the depth of the depression in the 'thirties, the level of American industrial production and employment had been halved, whereas the reduction in Great Britain from the pre-slump level was only about 17 per cent. If this type of violent oscillation were to remain characteristic of the American economy and to continue to be communicated to other countries by declines in American demand and American foreign investment, what would become of the full employment policies on which we have set out to build our new systems of social and economic security? In order to withstand the impact of violent fluctuations of this order any country desirous of maintaining its own level of employment must be in a position to maintain a combined programme of liberal credits through the banking system and active intervention by the State to stimulate the demand for goods and services for either consumption or investment. But no such freedom can exist in a country which is tied to the gold standard or to any other standard that involves a fixed parity of exchange, unless it is so strongly placed as to be able to rely on its own resources and to do without imports to any extent that the falling off of exports may require. Between 1929 and 1932 wholesale prices in the United States fell on the average by practically one-third; and the cost of living fell by nearly a quarter between 1929 and 1933. How could other countries meet such a fall without drastic deflation, leading to mass-unemployment and widespread business ruin, if they were compelled to work under an international monetary system that required the maintenance of free convertibility of their currencies at fixed rates of exchange? Such countries as Great Britain clearly could not maintain full employment in face of a serious American recession unless they kept the fullest freedom to control both the movement of money across their frontiers and the conditions under which they carried on their foreign trade. For the United States, an alteration in the gold value of the dollar would

have comparatively little effect: for other countries, a similar alteration might be the only alternative to being forced into collapse and the only means—I will not say of escaping—but of reducing the impact of an American crisis upon their own economic affairs.

Let me be quite plain about this, even at the risk of being tedious. The United States now holds so dominant a position in the economy of the greater part of the world that other countries are bound to be deeply affected by fluctuations in its affairs. If there is a boom and the Americans start stock-piling, or even buying heavily to meet current needs, the effect is to force up the prices of raw materials to fantastic levels and to bid other countries out of the market for those which are scarce in relation to the inflated demand. If, on the other hand, the Americans fall into a depression and greatly reduce their purchases both of imported materials and of imported finished goods, the supply of dollars is cut down and other countries can no longer afford to buy those foodstuffs and materials which can be got only for dollars. Their exports collapse, not only because they can no longer sell them to the Americans, but even more because the countries which can no longer sell their primary products to the United States lose their purchasing power and have to cut down their imports from every source. In 1951, after the outbreak of the war in Korea, American stock-piling led to a sensational rise in the prices of raw materials which utterly upset the British balance of payments. No doubt, the countries which produced the materials benefited and were able to pile up large dollar balances; and, as some of these countries belonged to the sterling area, the sums which they did not spend at once went to swell the sterling area's dollar reserves. But these sums, though they appeared as part of the British gold and dollar balance in the Exchange Equalization Fund, belonged not to Great Britain but to the countries which had sold their products at inflated prices and had to be held ready for subsequent re-payment. The effect on the British, as distinct from the entire sterling area's, balance of payments was disastrous. The prices of British imports increased much faster than the prices of British exports; and there was a sharp financial crisis, which had to be met by drastic curtailment of imports, not only from the dollar area, but generally. If Great Britain had been on the gold standard and the British currency had been freely convertible, it is safe to say that the entire reserve of gold and dollars would have disappeared in the twinkling of an eye; for it would have been impossible, even if it had been wished, to stop the drain by domestic

deflation—which would have been, besides, a most inappropriate means of dealing with a sharp *rise* in world prices.

In the event, the Americans, when they realized the effects of their action—which was in effect to bid up prices against themselves as well as against other countries—reduced their buying and brought the prices of a number of materials sharply down. This, in conjunction with the restrictions on imports by other countries, averted the threatened world crisis and made it possible to prevent unemployment from reaching serious proportions in most trades. But, even so, there was a slump in the British textile industries, which lost a considerable part of their export markets, partly, though not wholly, because of the upset in prices.

Fortunately, Great Britain and other countries which depend on imported foodstuffs and materials and pay for them mainly with manufactured exports have not yet had to experience, since 1945, the effects of a really big American recession. But in 1949 even a moderate fall in American imports (and in American aid to Europe) precipitated a crisis which forced Great Britain to devalue sterling in terms of dollars. In that case, the Americans soon got over their depression and resumed their buying—and also came to Europe's rescue with dollars to be used for re-armament; and the crisis passed. There was, however, evidence enough that, had it continued, its effects on Great Britain and on most of Western Europe would have been disastrous unless they had been offset by an immense outpouring of further gifts of dollars—which would have been most unlikely to receive the approval of Congress had the United States been in the throes of depression at home.

In both these instances, the countries affected by the vicissitudes of the American economy (and of American policy in respect of foreign aid) were in a position to take measures for their own protection. Great Britain was able in 1949 to devalue sterling, as well as to control the exchangeability of sterling into other currencies or gold, and also to impose restrictions on imports, especially from dollar areas. Again, in 1951, though sterling was not further devalued, the control over its exchangeability remained, and so did the right to restrict imports in order to protect the currency. If these powers had not existed, nothing could have prevented a collapse which would have plunged Great Britain into mass-unemployment. But they would not have been enough had not the United States taken warning and reduced its stock-piling before the crash came.

I do not wish, at this stage, to enter upon a full discussion either of

foreign exchange problems or of international trade policies. For the time being, I wish only to point out that, under existing conditions, both boom and depression in the United States are bound to react sharply and adversely on the economies of Great Britain and of other countries which depend on dollar supplies and markets. This holds good, even while these countries reserve the power to vary the gold and dollar value of their currencies, to control currency movements across their frontiers, and to regulate their imports in order to protect their balances of payments. If the first and second of these powers were to be taken away by an international agreement to return to the gold standard and to make currencies freely convertible—and still more if the third power were to be removed as well—no country accepting such a system would retain any means of protecting its economy against the effects of upward and downward movements in the United States, and there would be no possibility of following a policy of full employment.

Where the gold standard is in operation, and prices fall or rise in the country which holds the leading position in the world economy, other countries which are tied to gold must bring their prices into line, even if there has been no change in their own internal conditions. If prices in the dominant country fall, they must reduce their prices. If they have currencies pegged to gold, they can do this only by enforcing restrictive monetary policies, in the hope that monetary restriction will bring down costs. Costs, however, are made up of many elements, some of which are fixed over long periods and some over shorter periods, while others are flexible almost at once. In face of the long-period fixity of many capital costs, and of the large element in costs which consists of wages, no policy of deflation can succeed in bringing down costs to the required extent unless it includes drastic cuts in wages. Such cuts, however, while they may benefit the export trades, will react most seriously on home consumers' demand. If the workers offer strong and successful resistance, costs will not be brought down, but employment will, because the deflated monetary structure will not make it profitable for employers to maintain production at the previous level. Thus, whether costs are brought down or not, the effect will be to depress production and employment, the incidence of the depression being different between trade and trade in the two cases, but the total effect disastrous in either.

I am not suggesting that a country which retains its freedom to alter the value of its currency can thereby escape the consequences

of fluctuations originating in the United States. Evidently, the United States holds much too important a position in the structure of world economics for such an escape to be possible under any conditions. What I am suggesting is that the disaster will be much less if such a country as Great Britain is not forced to add the calamity of internal deflation to the calamity of adverse conditions of international trade and investment.

It may be objected that there are other, and perhaps better, ways of insulating the national economic structure from the effects of crisis in America than a change in the external value of the currency or a control of currency movements. Perhaps there are; but they are equally ways that cannot be followed by a country which has pledged itself to abide by a fixed international monetary standard involving either fixed exchange rates or free convertibility. The external drain to which the situation we are postulating would give rise could be stopped only by altering the external value of the currency, or by restricting its export. A country may be able to achieve the required insulation by means of a thorough-going system of exchange control, while leaving the external or gold value of its currency nominally intact. It may refuse to supply gold for export, and may ration the supply of foreign exchange under a licensing system or by the adoption of various 'clearing' devices, so as to limit total outgoings to balance what is available at the fixed rate. Such devices are inconsistent with the gold standard: they lead, irresistibly, to a *de facto* depreciation through the appearance of 'blocked' accounts exchangeable only at a discount. There has been plenty of opportunity, both during the inter-war decades and since 1945, of seeing what happens under such arrangements. The gold standard, in the form in which it existed in the 'good old days', the form in which many Americans are still hopeful of putting it back, excludes such devices, fully as much as it excludes fluctuations in the gold value of the currency unit.

For my part, I am convinced that, even though the leading nations agreed at Bretton Woods, in response to pressure from the United States, to return after a breathing space to an international monetary standard which, despite a certain element of flexibility, bears in essence a strong resemblance to the old gold standard, either they will find it impracticable to carry out their promises when the strain comes, or, if the promises are implemented, breakdown will follow within a very short space of time—in effect, at least as soon as the first major economic boom or slump in the United States makes

sustained impact on the rest of the world. After 1918 immense efforts were made to get the gold standard back into working order; and, one after another, countries re-defined the values of their currencies in terms of gold. Scarcely had this painful process been completed when the countries began slipping off the restored standard a great deal faster than they had gone back to it. Indeed, this is an under-statement: the gold standard was already breaking down in some countries which had restored it before the process of restoration in others had been carried fully into effect.

Are we now to go again through this painful and futile experience of the inter-war years? It was obviously impracticable for most countries to return to the gold standard or to adopt any other arrangement involving a fixed exchange parity immediately the war ended. Conditions in many areas were much too confused; and it was beyond the wit of man to say what the appropriate parities should be. Accordingly, everyone agreed to the necessity of a period of transition during which countries could be setting their monetary and economic houses in order and finding out, broadly, what their several currencies looked like being worth. The Americans, however, appeared to be in an inordinate hurry, above all in their dealings with Great Britain, to bring this period of transition to an end, and determined to hasten on to a point at which a new monetary order could be instituted by the proclamation for each country, as its affairs settled down, of full convertibility of currencies at a fixed value in terms of gold. They seemed blind at that time to the danger that, even if this 'final' act were ever reached, countries would begin sliding off their fixed parities almost as soon as they were laid down.

This is not to suggest that unfixed currency values are a good thing in themselves. On the contrary, it would be much pleasanter if there could be fixed ratios at which the monies of all countries could be exchanged. It would be much pleasanter, unless the penalty of having this fixity were to be, for some countries at any rate, periodic plunges into deflation and mass-unemployment—or into wildly inflationary conditions.

It may be argued that, although this is true, it does not greatly matter because the United States is unlikely in the future to allow itself to fall victim either to a really severe recession or to a runaway speculative boom. It may be argued that since the New Deal and the advent of Keynesian economics the techniques required for preventing serious recessions have been learnt, and that the United

States is fully in a position to apply them—even if other countries are not. Surely, it is said, if the United States can follow a policy which will maintain full employment, American prosperity will boost the rest of the world into prosperity just as effectively as American depression would impel it into deflation. There is, of course, some substance in this view. There would be very much less to be said against restoring the gold standard if it were possible to feel any assurance that the United States would follow in the future a consistent policy of full employment without boom. But how can anyone feel such an assurance? The most powerful business interests in America never ceased from proclaiming loudly their detestation of the 'New Deal' in all its aspects, and their determination to have no more of it. Yet what was the 'New Deal' except an attempt by President Roosevelt to follow a policy of full employment as far as the limits set by the American Constitution and the peculiarly resistant attitude of American business would allow? A Government cannot follow a full employment policy unless it is able to intervene largely in the conduct of private business and to spend largely out of public funds in sustaining demand when it threatens to fall short. The 'New Deal' was allowed to happen because in the circumstances of 1933 the American business world lay prostrate. But no sooner was any business man back on his feet than he began loudly vilifying the hand that had raised him up. It would indeed be optimism to suppose that this mood has passed away among the Americans, that from now on American Governments can be relied on steadily to pursue policies of full employment, or that American business is likely in the near future so to re-organize itself as to shed its instability and provide for a steady level of high production and high employment without government interference.

Since 1945 high employment in America has been sustained largely by means of huge gifts which have swelled the demand for American products—and of intensive re-armament. It can hardly be supposed that either of these factors will continue to operate indefinitely: indeed, the speedy ending of one of them has been announced already. If they both ceased to operate, the Americans *could*, no doubt, find useful means of keeping all their vast productive resources fully employed. Whether they would, at any rate until they had learnt the lessons of a depression, is another matter; and, even if they did, and used their resources at home, that would not save other countries from the effects of a falling supply of dollars.

Moreover, even if it were agreed—and I do not agree—that a serious American recession is unlikely, what about an American speculative boom? That possibility, at any rate, cannot be ruled out, even if in theory the techniques needed for preventing it are also known. A boom like that of 1951, if it were to occur when dollars were no longer being passed into Europe through some form of foreign aid, would upset the economies of Western Europe—and of Great Britain in particular—quite disastrously unless the British economy had full freedom to take whatever measures were found necessary, either alone or in conjunction with other countries similarly affected, to protect itself—measures which would certainly have to include freedom to control currency movements as well as to regulate international trade.

It is, of course, easy to understand the widespread desire among Americans to give the world a strong push back in the direction of gold as a basis for convertible national currencies. They have the stuff—far more of it than they can possibly find any use for in the United States—and most of this gold has been taken in exchange for American exports for which they have received no other return, and is now costing good dollars to store and having to be 'sterilized' in order that it may not exert its full inflationary effects on the credit structure and the price-level. In June 1953 the American gold reserve stood at over 22,500,000,000 dollars—an astronomical figure ten times that of the entire sterling area's and out of relation to any possible need. This accumulation has indeed ceased during the past few years, but only because (*a*) gold production has fallen off on account of the reduced value of gold in terms of goods, and (*b*) the reserves of most other countries have been depleted to a point at which they can spend no more on purchases of dollar goods. The immense accumulation remains. This gold stands at its dollar value as the capital asset held against debts owing by the American Government and its banking system to the citizens of the United States. If its value had to be written off, the taxpayers of the United States would not necessarily be any worse off than they are while they have to pay the interest on the sum immobilized in holding the gold idle; but there would be a large book-keeping loss, in that there would no longer be any capital asset held against the debt. It is therefore very much a matter of concern to the United States Treasury that the gold stock should retain its value; and this is part of the reason why the United States was willing for many years to go on acquiring gold which it could not possibly use or want. A

refusal on the part of the Americans to receive gold would have had a double effect. It would have meant that they could not have got payment for their exports unless, by lowering or abolishing their tariff, they had allowed their debtors to pay in goods for sale

TABLE XXIII

GOLD RESERVES OF LEADING COUNTRIES

	End of Year		
	1938	1945	1953
	Millions of U.S. Dollars		
United States	14,592	20,083	22,091
United Kingdom	2,877	2,476	2,518
France	2,757	1,550	575
Holland	998	270	737
Belgium	780	733	776
Switzerland	701	1,342	1,406
Argentine	444	1,197	268*
Sweden	321	482	219
India	274	274	247
South Africa	220	914	176
Canada	180	354	986
Italy	193	24	346
Japan	230	—	18
Portugal	86	433	361
Indonesia	80	201	145
Uruguay	72	195	223
Egypt	55	53	174
Brazil	32	354	317
Turkey	29	241	143
Mexico	28	292	144*
Persia	26	149	138*
Venezuela	—	169	373

* 1952.

in the American market; and, over and above this, it would have meant a catastrophic fall in the value of gold, because no other country could have afforded to replace America as a buyer.

It is part of the gold standard system that a country which accepts it must be prepared to receive at the price which corresponds to the gold value of its own currency any amount of gold that anyone

may choose to sell to it at that price. For years before 1939, the world price of gold was determined by the buying price of the American Treasury and Federal Reserve Board; and this price determined the volume of gold production throughout the world. It was a high price, in relation to the costs of mining gold; and the effect of it was that the output of gold was rapidly increased, despite the fact that nobody really wanted the gold that was being mined. Mines which had been given up as unremunerative were brought back into production, and output at mines of better productivity was increased. Huge presents of windfall profits were made to the owners of gold-mines—to be taxed away, in part, by the States in which the mines were situated—e.g. South Africa. The Soviet Union managed to pay for a substantial part of its imports with newly mined gold, and was thus relieved of the necessity of exporting commodities which were badly needed for consumption at home. The purchase of gold by the Americans became a method whereby the rest of the world was enabled to keep up a relatively high level of commodity purchases from the United States. Even the gold-miners profited from better employment and from the practicability of getting higher wages as a result of the prosperity showered on their employers by the beneficent gold-buying policy of the United States.

For all this the American taxpayers had to foot the bill. But in the 1930s the United States could not stop buying gold without bringing disaster on its own exporters and provoking an outcry about budgetary losses from the very persons who were bearing the burden. The situation was farcically absurd; but it suited both the countries of the British Empire which are large gold-producers and the Soviet Union, and it seemed to be in no one's interest to incur the risks of putting a stop to it. The production of new gold rose to fantastic heights: the less was wanted, the more was produced. Some day, the gold bubble seemed certain to burst. But when?

The necessity under which the United States was of adding continually to its stock of unwanted gold rested, of course, in the first instance, on the unbalanced condition of American import-export relations. The Americans were still trying, throughout the 'thirties, albeit with some misgiving, simultaneously to stimulate exports and to restrict imports in order to protect American industries. They were trying to sustain an economic position which could be balanced only by a steady export of capital on a large scale, or by gold imports. As the openings for foreign investment did not seem good

under the prevailing conditions of world economics, gold imports had to be used as a means of squaring America's international accounts.

Since 1939 conditions have changed radically. If a currency represents a fixed amount of gold for each unit, the higher commodity prices are the less an ounce of gold will buy. The costs of gold-mining are affected, equally with those of other industries, by rising prices: so that as commodity prices rise the less productive gold-mines become uneconomic to work. This effect may be mitigated if the Governments of the gold-producing countries have been putting special taxes on the profits of gold-mining, and if these taxes are reduced or removed as profits fall. But just as the over-valuation of gold in the 1930s, because of American readiness to buy at a fixed price, stimulated gold production, so the fall in the value of gold in terms of other goods has caused a fall in output.*

Very naturally, the American Treasury would like to get rid of as much as possible of its huge accumulation of unusable gold. It did a little in this way both before and during the war by means of gold payments to Latin America; and one Latin American country after another was enabled to stabilize its currency with the aid of American loans or American payments for wartime supplies. But the net effect of these outwards movements of gold was very small in relation to the magnitude of the available gold stock. At the end of 1942 the published figure for this stock was 22,726,000,000 dollars; by the end of 1945 it had fallen only to 20,083,000,000. By the end of 1949 it had risen again to 24,563,000,000; and then it fell again to 22,521,000,000 in June 1953. But in December 1938 it was but 14,592,000,000, and in December 1929 but 6,602,000,000 in terms of the present gold content of the dollar, or 3,900,000,000 at the dollar value then current, i.e. before the devaluation of the currency during the world depression.

The Americans would have liked, after the war, to replenish with gold reserves the depleted Central Banks of all the other belligerent countries, on condition of a return to full convertibility at fixed rates of exchange. They would have liked to trade off as much as possible of their surplus gold in this way. Use it for paying for imports they could not; for apart from any payments from this source they seemed certain to have a large surplus of exports. The gold, if it was to go out at all, could go out only by way of gift or loan; and some of it did go out in these ways, but not enough to

* For the figures of gold output see the Table on page 34.

make any appreciable difference to the size of the American reserve. The United States Treasury, however, desired, in the interests of 'economic stability', to persuade other countries to return to the gold standard; it would have liked to get some return on a part of its surplus stock of gold; and it had hopes of getting relieved of the burden of being virtually the sole buyer of newly mined gold in the future. The United States Treasury therefore started with a strong presumption that a general return to the gold standard would be a good thing; and, as the internal credit policy of the United States was not in the least likely to be hampered in any way by the pegging of the dollar to gold, American financial opinion was unduly ready to conclude that the same thing must be equally true of other countries.

Nor is this all. The gold standard is essentially a *laissez-faire* standard. It rules out such methods of economic management as involve restrictions on exchange transactions. The Americans are apt to regard such restrictions, from whatever cause they spring, as manifestations of the evil spirit of 'economic nationalism', to which they see no objection when it takes shape in the American protective tariff, but a sign of economic depravity when it expresses itself in ways which meet the needs of other countries.

The fundamental question, however, is whether other countries can possibly afford to accept the gold standard, in the sense either of incurring the cost of building up a stock of gold as a basis for their currencies, or of accepting a stable relation of these currencies to something so essentially unstable in its impact on the rest of the world as the American dollar. A gold stock is an expensive luxury, even if it is no longer to be regarded as necessary to hold a large part of it immobilized as a reserve against the internal currency, and if no more is attempted than the creation of a fund adequate to stand up against any probable external drain. The external drain, as one crisis after another since 1945 has all too plainly shown, is potentially enormous, and the reserves required to meet it under full gold standard conditions would be far too great for most countries—and certainly for Great Britain as the banker of the sterling area—to afford. Gold can be accumulated only by paying for it with exports, or by borrowing it; and countries which are hard put to it, even with American aid, to maintain a balanced condition of their current import-export accounts cannot possibly afford to buy large quantities of gold, especially if they are in need of imports of real goods which will help to increase their productive

power. There is something not a little absurd in attempting to force the needy debtor, who cannot pay for his current purchases, to accept an additional purchase of what he does not want. But this was in effect what was involved in the attempt to force the world back to the gold standard—or, at all events, to something very like it.

Yet it would be manifestly inconvenient if the gold bubble were to burst all at once. It would be foolish to suggest that, because the world has already more gold than it needs, it should suddenly stop producing any more. If the United States ceased to be an open market for gold, nothing could avert a complete collapse of its value; if the United States, for reasons of its own, is prepared to go on buying, so much the better for everyone else—provided that we do not expect so absurd a situation to continue for an indefinite period ahead.

One further factor of which it is necessary to take account in considering the expediency of a general return to the gold standard is the difference in the rate of economic progress between one country and another. If technical efficiency is advancing faster in one country than in others, and if its effects in cheapening commodities are not offset by other factors, such as a growth of monopoly or a piling up of selling costs, its goods will become cheaper than those of the countries in which technique is developing less fast. This will tend to increase its exports and to reduce its imports, at any rate in the short run, and will react unfavourably on the economic position of other countries which are tied to it by a common currency standard. No doubt, in a perfect economy of *laissez-faire*, the position would be redressed in the long run by a migration of population and resources to the country in which they could be most productively employed. But this tendency would in practice be strongly resisted, not only by the countries which stood to lose population and industry, but also by the countries which stood to gain them. The theoretical restoration of equilibrium would not in fact take place, except over a very protracted period—even if it took place at all.

Now, a country which is falling behind the pace of the foremost in improving technical efficiency can to some extent check the loss of trade which it would otherwise incur by allowing the relative value of its currency to fall. Such a measure will be effective in the long run only to the extent to which internal costs and prices fail to rise in correspondence to the changed external value of the currency. But in the short run the protection afforded may be

considerable, and may be of substantial value if the time is used, not to bolster up inefficiency, but for improving the pace of technical advance and for eliminating unnecessarily high overhead costs. It will be answered that this is a dangerous line of argument, because in practice a country which resorts to this method of protecting itself against the competition of the more efficient will be more likely to remain inefficient than to re-adjust itself to an improved technical level. I do not at all dispute that this danger exists, especially wherever a country is subject to monopolistic conditions and such bodies as cartels are allowed to exert an effect on national economic policy. But freedom to adjust currency values may be preferable to tariff manipulations, in circumstances in which a country is not prepared to accept the full consequences of a decline in its relative efficiency without some attempt at giving itself time to improve its methods of production and distribution in order to redress the balance. Tariffs can never help the export trades: currency changes can. And this may be a most important consideration for a country which is finding difficulty in balancing its international accounts. Of course, any fall in the value of the national currency in relation to others will add to the cost of imports as well as reduce export prices to foreign buyers. None the less, the effect may be to ease the situation to the extent to which a group of complementary countries can act together. But this, it will be said, is surely to advocate the continuance in the world of separate regional currency areas, such as the 'sterling area'. Why not? I am well aware that the 'sterling area', or any other regional monetary grouping, has been anathema to the exponents of American monetary policy. But I find their attitude wholly unconvincing; and I doubt if American opposition is now nearly as strong as it was when the discussions at Bretton Woods and in connection with the United States Loan of 1946 were in process. I believe there is much more hope of getting stable economic progress in the world if countries which have close economic relations based on complementary needs are left free to make mutual arrangements both for the exchange of goods and for the settlement of their currency problems—even to the extent of establishing common currencies among themselves—than if they are all tied hand and foot on the plea that any arrangement that is less than universal is mortal sin. I would much sooner see common currency systems established, say, over Western Europe or in the British Commonwealth, or in other great regions of the world, with freedom left to vary the rates of exchange between these

regions, than see all countries, in the name of 'free exchanges', tie their economic fortunes tightly to those of a single country—and, at that, to a country noted for speculative excesses and economic fluctuations of the most extreme and illogical nature. It is a worthy objective to break down the narrow barriers of economic nationalism; but let us beware lest, in doing so, we become the victims of an international policy which reflects the economic nationalism of the United States.

It must of course be admitted that the old gold standard, as far as it was observed, had the merit of preventing countries from trying to snatch advantages at one another's expense by manipulating the exchange rates. Freedom for each country to regulate its monetary affairs as it pleases necessarily provides the opportunity for abuse. But, as against this, the gold standard meant that countries bound by it were forced to follow monetary policies that did not necessarily suit their conditions and might involve them in heavy unemployment which they could have avoided without any damage to their neighbours. There is a valid case for making currency changes, whenever practicable, only after consultation with countries liable to be affected by them; but this is a very different thing from passive acceptance of gold as the regulator of monetary policy. What I am arguing for is not complete freedom to vary exchange rates at will, but freedom to adopt less than universal arrangements for convertibility and to make, subject to consultation, adjustments in the light of national or regional needs rather than be bound to a common system which would mean in practice the domination of a single country subject to extreme fluctuations of its own.

XIII

EXCHANGE CONTROL

If countries are not on a fixed international standard, it does not follow that they must let the external value of their currencies fluctuate in accordance with the day-to-day conditions of supply and demand. We have seen that, in fact, in the 'thirties, when the gold standard was largely in suspense, most countries did establish some mechanism for regulating the course of their exchange rates. The methods varied from Exchange Equalization Funds, such as were operated by Great Britain, the United States, and a number of other countries, to the forms of Exchange Control and Clearing Agreement which found favour with those countries—such as Nazi Germany—which decided to maintain the nominal gold parity of their currencies while endeavouring to insulate themselves internally from the deflationary effects of such a policy, and also with those weaker States which were driven to financial extremities by the sharp fall in the world prices of the primary products they exported.

Since 1945 there has been even greater need to control the movements of money across national frontiers. The Table on page 290 shows how extraordinary the conditions affecting the balance of payments have been. In face of heavy trading deficits, the countries of Western Europe and others affected by the war have been able to balance their international accounts only with the aid of large donations and investments of capital, including loans, from the United States, and, to a smaller extent, from Canada; and, even so, the balance has been achieved only by means of drastic limitations on imports and strict control of currency movements. Capital movements in particular have had to be very severely controlled, and there have been restrictions on such things as tourist expenditure as well as on transfers of funds for commercial purposes which would have put an undue strain on the exchanges.

The Table on page 290 shows that, over the six years from 1946 to 1951, the United States had a total export surplus (including the balance of payments for transport) amounting to $33,700,000,000 and, in addition, received in dividends and interest from abroad $8,164,000,000 more than it paid out to foreigners. This vast surplus was got rid of by giving away more than $25,000,000,000 and by lending or investing at long term more than $15,500,000,000. Over

TABLE XXIV

Balances of Payments, 1946–1951

Excess of Incomings (+) or Outgoings (−) over the whole period 1946–1951. The totals are only approximate, and fail to balance because the information is incomplete. They come mainly from the Reports of the International Monetary Fund. They are in millions of the currencies stated.

	Merchandise and Transport	*Interest and Dividends*	*Other Services* *	*Donations*		*Long-Term Capital*		*Other Services* ‡
				Public †	*Private*	*Public*	*Private*	
United States ($)	+33,699	+8,164	− 813	−21,914	−3,396	−9,286	− 6,233	− 3,921
Canada ($ Can.)	+ 2,587	−1,829	− 102	− 399	− 67	−1,492	− 1,730	− 1,440
France ($)	− 6,874	+ 182	− 954	+ 2,743	—	+2,078	+ 301	+ 2,515
W. Germany § ($)	− 3,077	− 5	+ 41	− 1	+ 280	+3,122	—	− 305
Italy ($)	− 2,677	− 48	+ 469	+ 1,721	+ 644	+ 574	+ 441	− 929
Greece ($)	− 2,100	− 12	+ 35	+ 1,687	+ 100	+ 141	+ 84	+ 84
Japan ($)	− 1,725	− 17	+ 618	+ 2,091	+ 62	+ 12	+ 53	− 1,141
United Kingdom (£)	− 1,738	+ 698	+ 133	+ 176	− 78	+1,058	− 687	+ 383
Australia (£A)	+ 337	− 236	− 97	− 3	+ 26	− 140	+ 214	− 495
India (rupees)	− 3,519	− 765	− 1,109	− 59	+ 566	−1,595	− 1,505	+ 7,404
Belgium and Luxembourg (francs)	−60,391	+3,396	+15,488	+ 2,721	+2,751	−7,702	+22,424	+22,814
Holland (guilders)	− 7,700	+ 965	+ 1,093	+ 2,943	− 1	− 242	+ 385	+ 1,693
Turkey (£T)	− 633	− 96	− 82	+ 649	+ 40	− 28	+ 53	+ 393

* Including Tourism and miscellaneous government expenditure.
† Including Reparations and Lease-Lend settlements.
‡ Including movements of short-term funds.
§ Excluding transactions with E. Germany and U.S.S.R.

and above this nearly $4,000,000,000 went out mainly in short-term lending; and 'other services'—mainly tourism and shipping—accounted for more than $800,000,000. These sums add up to more than the combined surplus of trading and investment income, and the difference is partly accounted for by gold exports, and is partly due to inaccuracies in the estimates.

Of course, further sums were given or invested in the following years; but as I write the full figures are not available beyond 1951.

This great outpouring of goods, and of the means of paying for them, from the United States went to many more countries than are included in the Table. A considerable amount of investment went to Latin America—especially Brazil and Venezuela—and to the oil-producing countries of the Middle East. France received, in terms of dollars, gifts amounting to nearly 3,700,000,000, Italy nearly 2,200,000,000, Japan more than 2,100,000,000, and Greece more than 1,700,000,000. Great Britain's net receipts in gifts were relatively modest, at less than £100,000,000, mainly because a large proportion of British receipts from the United States was offset by donations made by Great Britain to other countries—e.g. through UNRRA and for colonial development. In loans and long-term capital, public and private, France received a net sum of nearly $2,400,000,000, and Italy $1,000,000,000. Western Germany got more than $3,000,000,000, and Great Britain about £400,000,000.

These vast sums, and others which I have not detailed, by no means sufficed to bring the supply of dollars up to what would have been demanded if imports and supplies of dollars had not been controlled. There was much talk both about the need to liberalize trade by freeing importers and exporters from currency, quota and licensing restrictions, as well as by reducing tariffs, and about the wider aim of making currencies freely convertible in respect of capital movements as well as of current transactions. But in face of the dollar shortage it was sheerly impracticable to abandon the currency controls, though, as we shall see, various special steps were taken towards a limited freedom in respect of current transactions, especially between European countries and within the sterling area. More than this the dollar shortage forbade, although, under strong pressure from the United States, all the leading countries of Western Europe made large promises about their intentions for the future. There were also changes in the relative values of currencies, made unavoidable by the strong position of the dollar in relation to the rest of the world.*

* For these changes see Table VI, page 89.

The principal change in relative currency values took place in September 1949, when the United Kingdom was forced into devaluation after an attempt had been made to loosen restrictions as a sequel to the Marshall Aid system. The pound sterling was then devalued from 403 to 280 United States cents and correspondingly in gold value. Many other countries at once followed the British example and devalued their currencies, some to an equal extent, others less or more. Between 1949 and 1954 no further general changes occurred, though fluctuations took place in the values of particular currencies—e.g. the Argentine's and Spain's. But the apparent stability of the years after 1949 did not represent any real return to equilibrium. American dollars still had to flow out in gifts of military aid, even after economic aid had ceased, in order to maintain the precarious balance; and the European financial crisis of 1951, arising out of the Korean War, had to be met by fresh restrictions on imports throughout Western Europe and the sterling area.

It can indeed be said that, even nine years after the end of the war, there were no 'natural' rates at which the exchanges would have settled down if the restrictions on trade and currency had been lifted; for in such circumstances the demand for dollars would have reached proportions that would have compelled the countries affected immediately to put the restrictions back. Despite this evident impossibility, the American authorities continued to talk about a speedy return to free convertibility, and bankers and politicians in other countries paid lip-service to the idea. But it was all nonsense, as matters stood: everyone in his senses knew that, even if the Americans had been prepared to present other countries with enough gold and dollar reserves to make free convertibility possible for a time, before long any balances of this sort would have been used up, and convertibility would again have to be given up.*

As we have seen, Exchange Equalization Funds, however large, cannot stand out against really persistent tendencies making for a change in relative currency values. They can only check currency speculation, iron out short-term fluctuations, and, by mutual agreement, support for a time currencies which are attacked by such adverse forces as 'loss of confidence' or deliberate 'bear' pressure. Involving no direct interference with the course of either trade or capital movements, they can act only as the interpreters of long-term as against short-term forces of supply and demand, and cannot in-

* For a discussion of proposals for limited convertibility of foreign-owned sterling, see page 401.

fluence the former save to a minor extent. No doubt, if an Equalization Fund is equipped with very large resources which it can turn into gold or foreign currencies, it can operate for a proportionately long time even against a persistent tendency; but an Equalization Fund has no magic power to acquire either gold or foreign exchange in place of the national currency unless the conditions favour such acquisition. A country which has a favourable balance of payments can easily build up a large stock of gold or foreign exchange: a country with an unfavourable balance has no such power. True, conditions may arise in which a country with an unfavourable balance of *current* payments finds itself able to acquire gold or foreign exchange because of an influx of short-term capital—sometimes known as 'hot money'. But such a situation is exceptional; and in general an Equalization Fund is an interpreter of long-term trends and not an instrument for causing the rates of exchange to be different in the long run from what they would have been in its absence.

Exchange Controls work in quite a different way; for they are, in general, instruments for altering, or artificially stabilizing, rates of exchange by influencing the volume of transactions carried on across national frontiers, both by affecting their total amount and by directing their flow into particular channels. The essence of exchange control is that the possessor of the controlled currency has no right, without special leave, to convert it into foreign currency. His right is limited to a greater or a lesser extent. There may be merely a global limit on the total amount of this or that foreign currency to be supplied, and the supply may be on the principle of 'first come, first served'; or there may be, and usually is, some rationing of foreign currencies in relation to the purposes for which they are needed. Thus, foreign currency may be demanded (*a*) to pay for imports of goods or services, (*b*) to pay interest or dividends due on capital borrowed abroad, (*c*) to take money out of the country for tourist or commercial travelling expenses, (*d*) to make remittances to relatives or friends abroad, (*e*) to make short-term loans abroad for financing trade or production, (*f*) to make long-term investments abroad, (*g*) to escape out of a currency in which no confidence is felt into another, (*h*) for purposes of permanent emigration from one country to another. This list is not meant to be exhaustive, and it omits government payments, which may be of great importance—e.g. the cost of maintaining armed forces abroad; but it serves to indicate the main types of demand.

Different degrees and forms of restriction may be applied to

demands for foreign exchange according to the purposes for which it is wanted. A country which is trying to reduce the demand for other currencies in exchange for its own may limit itself to a ban on capital transactions, or even on certain kinds of capital transactions, such as overseas issues in its home capital market.* Or it may, if the pressure is greater than can be met by such means, set to work to limit imports by refusing to supply foreign exchange except for those purposes which are regarded as 'essential'. Imports can, of course, be restricted by other methods besides exchange control—by tariffs, for example, or by quotas, such as Great Britain applied to bacon and other foodstuffs in the 1930s, or by licensing, such as Great Britain used between the wars in the case of dyestuffs for building up the home industry and, in common with other countries, has used much more extensively since 1945. Exchange control may be used as an alternative or as a supplement to such measures of direct control over international trade.

Again, a country which has to meet interest or dividend claims on foreign-owned capital can 'block' the transfer of such sums across the national frontier, either absolutely or under certain conditions. For example, the sums due may have to be paid into 'blocked' accounts at the Central Bank, to be drawn upon only for certain purposes—for current spending inside the country, or for the purchase of goods for export, or for long-term investment inside the country. Such 'blocking' may be the only alternative to actual default on bonds or shares belonging to foreigners, and may, of course, be temporary. While it lasts, sums in 'blocked' currency will obviously tend to be worth less than nominally equal sums which are freely convertible into foreign exchange. In other words, the 'blocked' money may, and usually does, go to a discount: so that there appears a second *de facto* rate of exchange different from the official rate, and maybe quite a number of such *de facto* rates, if there are a number of different kinds of 'blocked' account. In the 'thirties, the number of different kinds of German *reichsmarks*, each with its own current market value, became quite bewildering.

Since 1945 certain countries, notably the Argentine, have attempted to deal with their currency difficulties in ways closely resembling those of the Nazis. In addition to blocking interest and

* Such capital controls are allowed under the Bretton Woods Monetary Agreement, which in general outlawed exchange control over payments arising out of current transactions, though it had to recognize their inevitability for the time being.

dividend payments, the Argentine has fixed different rates of exchange for the *peso* in different kinds of transaction, and has thus tried to discriminate against some types of creditors while favouring those who have to be paid in full because they perform indispensable services. In other cases, there have appeared, side by side with the official rates of exchange, 'black-market' rates which are tolerated and 'grey-market' rates which are unofficially recognized. For example, in May 1953 there were two regularly quoted rates for the Italian *lira*—an official rate of 0·16 of a cent and a 'curb' rate of 0·1594. Even countries which did not tolerate 'black-market' or 'grey-market' rates for their own currencies within their own frontiers could not prevent such rates from being quoted and tolerated elsewhere. Wherever a particular currency was under pressure, holders of it in other countries were apt to offer it at a discount. This happened to the pound sterling in New York in 1949, and at other times. If such dealings develop on a large scale, the official rates may become untenable, and devaluation may have to ensue. In the final resort, a currency is worth in terms of other moneys only what buyers of it are prepared to give; and if there are large supplies on the 'black market', no one who can help it will exchange at the official rate.

Where restrictions are in force, there will always be attempts to evade them. If money cannot be taken out of a country freely, there will always be persons who will be prepared to accept less than its nominal value in order to get it away. Capital movements can often be camouflaged as current transactions, in the hope of escaping any ban on them; and where the sum in cash that may be taken out of a country is restricted, smuggling of currency will always occur. It is common for countries which have established exchange control to restrict the amount of money which anyone leaving them may take out. Such restrictions apply both to tourists, who are generally cut down drastically, and to commercial emissaries going abroad, who are usually better accommodated. They apply to foreigners leaving a country after a visit, and to residents who wish to leave it permanently. Wealthy persons who wished to escape from Germany under the Nazis were often allowed to take a small fraction of their fortunes out with them on surrendering the remainder to the State —or sometimes after using most of their money in greasing the appropriate palms.

With such restrictions on taking money out of a country often go requirements about bringing money in. Exporters who sell goods

abroad, or capital-owners who are due to receive foreign interest or dividends, are compelled to surrender their receipts to the Central Bank or to the Government, which then makes payment to them in the national currency either at the official, or sometimes at a special, rate of exchange. Attempts are made, with varying success, to prevent persons from leaving or re-investing abroad sums due to them in foreign money; but such restrictions are peculiarly difficult to enforce with any completeness—especially against businesses which carry on operations in more than one country.

In sum, exchange control has many degrees of stringency and can be applied over a narrower or a wider field. It is naturally most stringent where a country is maintaining an official rate of exchange widely different from that which would establish itself if no control were being exercised (e.g. Nazi Germany), and least where a mild influence is enough to bring the supply and demand forces into balance at the rates of exchange which the monetary authorities are endeavouring to maintain.

The Americans, in the international monetary discussions which culminated at Bretton Woods, were insistent not only on the necessity of fixing as soon as possible the gold values of the various national currencies but also on that of getting rid of all forms of exchange control over current transactions. These two objects may, however, be fundamentally inconsistent. If countries are compelled to adhere to fixed ratios of exchange for their currencies, they may be totally unable to maintain these ratios without measures of strict exchange control, not only over the movements of capital but also over demands for foreign exchange arising out of current transactions. Such control may be, in effect, the only alternative, in the circumstances in which they find themselves, to a degree of internal deflation which it may be intolerable to enforce, or politically impracticable to attempt.

The German example in the 'thirties showed that it is possible for a country, with the aid of strict exchange control, to maintain its currency officially at a highly artificial external value, and at the same time to pursue policies of internal expansion which would be entirely ruled out if the exchanges were left free. This cannot, as we have seen, be done without the appearance of *de facto* rates of exchange different from the official rate; and it has usually the paradoxical result that the controlled currency acquires in terms of other currencies varying values which do not correspond to the relative values of these currencies in terms of dollars or sterling.

Although the official rate was uniform, a *reichsmark* had in practice in the 'thirties one value in Romania, another in the Argentine, and another in Turkey; and these values did not correspond to the values of the Romanian, Argentinian, and Turkish currencies in other parts of the world. Such differences were the outcome of the 'clearing' arrangements which have been discussed in an earlier chapter*; and the conclusion of 'clearing agreements' is a natural sequel to any far-reaching exchange control designed to preserve an artificial rate of exchange for all transactions not covered by special arrangements.

It is easy to understand the desire to get away from the tangle of exchange restrictions which almost everywhere beset foreign trade. But the attempt to insist upon fixed parities, so far from furthering this object, would in practice make the enforcement of drastic exchange restrictions absolutely unavoidable. If a country which is in difficulties over its balance of payments may neither allow its exchange rates to alter nor impose exchange controls, what is it to do? The *laissez-faire* purist would presumably answer that it must carry through measures of internal deflation on a sufficient scale to put its balance of payments right. But this may be a task altogether beyond the power of its Government; and an attempt to enforce the carrying out of such a policy would be much more likely to provoke revolutions over most of the world than to result in a return of stable economic conditions.

If there are to be fixed exchange parities between the dollar and other currencies, there will have to be exchange controls, as the only means of upholding these parities, at any rate for a long time to come. Moreover, even if fixed exchange parities cannot be maintained, exchange controls will still be needed, though it will not be necessary for them to be quite so drastic if countries retain the power to alter the dollar value of their currencies. Even if no restrictions were imposed on the freedom of countries, or groups of countries, to vary their rates of exchange, no country subject to continued pressure for dollars would wish to leave its exchanges to fluctuate uncontrolled. There would be, at the least, some attempt to eliminate speculative movements and to iron out short-term fluctuations. Some countries might be able to achieve what would be needed mainly by the use of Exchange Equalization Funds without applying exchange control over any wide field; but most countries, including Great Britain, would have to keep power to control not only

* See pages 21 ff.

capital movements, both short and long, but also the supply of foreign exchange available for buying imports.

Doubtless, the extent to which this latter form of control will need to be used will depend in part on the extent to which the countries concerned control imports by more direct methods—tariffs, quotas, and licensing arrangements. The Americans, however, take objection to quotas and licensing even more strongly than to exchange control; and if only the tariff method were to be left open as a way of directly controlling imports, most countries would have to fall back on supplementing tariffs by the indirect instrument of exchange control. The weakness of a tariff is that it is very apt to keep out, not the less essential, but the more essential imports, and in addition to give home producers the means of raising the prices of necessary goods. Both quotas and licensing and exchange controls can be used much more easily to discriminate against unnecessary imports; and a country which is compelled by its economic situation to restrict imports can hardly be expected to give up its right to use any method except the tariff. The more quotas and licensing are used, the less exchange control will be needed, and *vice versa*; but the degree of lack of balance in the world's economy is likely to be so great for a considerable time to come as to make it quite impracticable to rule out both the alternative methods of regulation.

Quotas, import licences, and foreign exchange controls are alike methods of regulating the quantity of imports. Any of these forms of control is capable of being used, not merely to limit the total quantity of imports, or to give priority to essential over non-essential supplies, but also to 'discriminate', so as to encourage trade with one country rather than another. This kind of 'discrimination' enters in much more when there are 'clearing agreements', designed explicitly to foster trade between two particular countries. The Americans pronounce 'discrimination' and 'bilateralism' in international economic relations to be anathema, and declare that it is essential to return to a 'multilateral' system under which all countries are treated alike. Under a multilateral system, one country may sell more to another country than the latter can pay for with its exports to the former, and the difference may be settled by the second country having a surplus of exports to a third country, which in turn exports more to the first country than it imports from that country. The actual system of trading exchanges may be much more complicated than this, so as to involve a large number of countries before

the balance is completed; but no difficulty need arise if in the end each country has bought from all the others taken together as much as it has sold to them—or rather so much more or less as is made desirable by its creditor or debtor situation or its import or export of capital. Thus, in the past Great Britain has been in the habit of buying more from the United States than the United States has bought from Great Britain; but Malaya has been in the habit of selling more to the United States than it has bought from the United States, and of buying more from Great Britain than it has sold to Great Britain, after allowance has been made for what it must send to Great Britain as payment for the use of British capital invested in Malayan tin and rubber. Therefore, a part of Malaya's exports to the United States has been used to pay for British imports from the United States; and in this way a part of the adverse British balance has been settled.

It would be obviously a great hindrance to international trade if this sort of thing could not be done, and if each country's trade with each other had to balance. Indeed, any such situation would be utterly absurd. The effect would be seriously to diminish the possibilities of the 'international division of labour'—that is, of each country's specialization in making on a large scale those things which it is good at making, and in which, in the language of the economists, it enjoys a 'comparative' advantage. It is indispensable, if international trade is to flourish and if the production of wealth is to be maximized over the world as a whole, to make provision for multilateral exchanges of goods and services, and not to attempt to reduce all foreign trade to a series of bilateral exchanges. So far the contention of the Americans undoubtedly holds good.

It does not, however, follow from this that there ought to be *no* bilateral exchanges. If two countries can, by making a mutual arrangement to 'swop' certain goods, render possible a series of trading operations which would not otherwise occur at all, or would be on a much smaller scale, the effect will be to enlarge and not to restrict the openings for international commerce. The United States has itself, in fact, entered into bilateral commodity bargains of this sort, not by way of currency clearing agreements but directly; and in the circumstances in which these exchanges were arranged—for the purpose of getting rid of otherwise unmarketable surpluses of goods—they were of advantage to both the participants, and not of necessity disadvantageous to anyone else.

The argument most commonly brought forward against any

form of international trade that is in any degree discriminative—that is, rests on any arrangements between two or more countries and is not open to all countries on equal terms—is that such arrangements protect the inefficient producer and rob the world of the full benefits of the 'international division of labour'. The usually unspoken assumption underlying this argument is that everything ought to be produced where it can be produced most cheaply and that, when a country cannot produce cheaply enough, its inhabitants ought to migrate to a country where their labour can be put to better use. Even if there were no legal restrictions on free migration from country to country, this argument would be nonsensical; for it ignores both the economic costs of migration and re-settlement and the human aspects of the question, and it further fails to take account of the claims of countries which are at a low stage of development to be given a chance to improve their productive techniques. In face of the artificial restrictions on immigration which are imposed by most of the advanced countries it becomes merely ludicrous to use the 'international division of labour' argument in its extreme form. It is not a matter of indifference in what country goods are produced, provided the costs of production are low: countries have to balance their trade, and can have no assurance of being able to do this if they are not to be allowed to take the necessary steps to achieve a balance. The Americans themselves see no harm in protective tariffs designed to protect high-cost American producers. They invoke the 'division of labour' argument only when other countries propose to take steps to develop mutual trade, instead of merely banging the door indiscriminately on imports.

Moreover, there is often in these disputations a confusion, which sometimes appears deliberate, between 'multilateral' and 'omnilateral' trading. It is undoubtedly an advantage when countries, instead of striking merely bilateral bargains involving bilateral clearing arrangements, can enter into multilateral schemes which allow open trading among a number of them. It is often possible to do this when it would be quite impracticable to open the same facilities to all countries—for example, to the United States in face of the scarcity of dollars. Nothing should be done to prevent such 'multilateral' agreements on the ground that they fall short of universality. On the contrary, in the present state of the world they offer the best hope of liberalizing trade relations in a realistic way.

The real basis of the opposition to bargains of this sort is two-fold. In the first place they stand in the way of the desire of American

exporters to secure unlimited access to all the markets of the world; for, as dollars are a 'scarce' currency for most other countries, there is obviously a tendency to strike bilateral bargains which reduce the need for imports that have to be paid for in dollars. Thus countries which are short of dollars try to arrange for supplies of necessary imports from countries which are prepared to receive their products in exchange; and to the extent to which this is done, American exporters complain that they are being shut out of markets that they might otherwise have supplied. This contention ignores the very pertinent fact that other countries cannot afford to buy American goods, even if they are competitively priced, unless there are means of paying for them, and that if, because of the American tariff and of the American consumers' preference for domestic products, payment cannot be made in goods, there is no means of paying unless the Americans are prepared to finance their own exports by continuing to make gifts to the purchasers. Gifts these must be, and not loans, because, again in face of the American tariff, there is no way of liquidating loans by subsequent exports of goods. It is easy enough to point out that it is foolish for the Americans to expect all the markets of the world to be wide open to them unless they are prepared to be paid in the only way in which real payments can be made. However convincing this answer may be in logic, it does nothing in practice to disarm the well-organized lobbies of the American business pressure groups, or to induce the Congress of the United States to take a realistic view of the needs of countries very differently situated from its own.

A second reason for the American attitude is that bilateral bargains are evidently calculated to promote some measure of state trading, or at least of trading between commercial organizations acting under the auspices of the State. American hostility to them thus becomes part of the fight against the 'New Deal' and against everything that savours even faintly of Socialism, or of state economic activity in spheres hitherto reserved for 'private enterprise'. Bargains for the bulk exchange of goods can hardly be made except between States, or between agencies set up by or having close association with States; and any system of rationing either imports or the means of paying for them, including any sort of clearing agreement, necessarily brings in the State or, at the least, a Central Bank acting with the State's authority. So, it may be said, do tariffs, to which even the most individualistic Americans are far from taking objection. But the difference between tariffs and other means of influencing the

course of international trade is that the State, having made a tariff, has nothing more to do beyond collecting the duties, whereas the working of quotas (and *a fortiori* licensing) and of exchange controls means continuous administrative intervention by a public authority. Moreover, if the trade between countries passes under any sort of quantitative regulation, the door is evidently set ajar to state or state-controlled arrangements for bulk purchase or bulk sale, to the creation of Import Boards and Export Boards, and to the supersession of the private merchant and the private merchant banker in certain parts of their traditional business.

Very often these reasons are not stated, and the opponents of any sort of special arrangements between States for the mutual exchange of products shelter themselves behind the arguments of the orthodox economists against bilateral and in favour of multilateral trade. There is, however, nothing in the making of collective bargains between States for bulk exchange of products that goes against multilateral trading, unless the bargains are designed to bring about an equality between the total imports and exports passing between the two countries. If Great Britain makes a bargain to supply the Danes with certain quantities of coal and machinery in exchange for Danish bacon, this is not in any way objectionable, or contrary to the principles of the 'international division of labour', unless it be part of the bargain that the total trade between Denmark and Great Britain must balance.

No doubt, bilateral 'clearing agreements' do involve precisely this notion of a bilateral balance of trade. They can, therefore, be defended only as expedients to which countries may be driven in periods of economic dislocation. But it would be foolish to extend the objection which applies to comprehensive bilateral clearing agreements covering all the payments that can take place between a pair of countries to all forms of bilateral trading, whether by direct exchange of goods or by some form of financial control.

Let us try to apply these generalizations to a specific case. It is manifest that for many years to come Great Britain will continue to be hard put to it to find means of paying for necessary imports. On the average of the three pre-war years, British net imports of food, drink and tobacco were valued at £403 millions, and of this £29 millions were spent on imported bacon, of which more than half came from Denmark. On the average of the three years 1950, 1951 and 1952 a reduced quantity of imported bacon cost £59 millions, of which Denmark received over £38 millions. Imports had fallen

from an average of 6·8 million cwt. before the war to about 4·8 million in 1950–52. Part of this deficit had been made up out of increased home production; but there remained a shortage of bacon in the British consumers' market. It would be possible, no doubt, to expand home production further; but only by raising prices at the consumers' expense. What is there unfair or unreasonable in a deal between Great Britain and Denmark to exchange bacon for British exports of kinds the Danes want? A bargain on these lines enables the Danes to expand a type of export they have shown special skill in developing, gives British consumers a more favoured product, and involves no exchange difficulties if the exports taken from Great Britain balance the cost of the bacon, after allowing on both sides for imported materials and feeding stuffs incorporated in the exports and also for the saving on imports of feeding-stuffs which would be needed to produce the bacon in Great Britain. This assumes, of course, that the Danes would not buy the British exports if we refused to buy their bacon; but this is a fairly safe assumption in the light of Danish import statistics in past years. Certainly, if Great Britain ceased to buy their bacon, they would have great difficulty in selling it elsewhere.

A bilateral bargain of this sort, so far from interfering with the 'international division of labour', positively promotes it. There is, however, a difficulty. Whereas it would be easy for Great Britain to purchase the Danish bacon in bulk, at an agreed price, and for Denmark to take British coal in exchange for a good deal of it, if the coal were available, there are few British exports except coal which can easily be sold in bulk at a fixed price to the Danish State or to any agency acting on its behalf. British exports, except coal, are mainly manufactured goods, diverse in character, and not so easily to be disposed of by bulk sales. This difficulty can be got over if the Danish bacon is paid for by a credit on London, to be expended on any kinds of British goods Danish buyers happen to want. This needs to be a 'blocked' credit, spendable except by special arrangement only in purchasing British products. Objection will be taken to it on this ground; but how else is Great Britain to pay? No difficulty would arise if Great Britain could rely on selling in the world market as a whole enough exports to meet the cost of all required imports. But if this were the case, there would be no need, on the British side, for the agreement. If it is not, surely it is better for Great Britain to pay for the Danish bacon in the way suggested than not to be able to buy it at all?

This sort of bilateral bargain was, of course, actually tried out, up to a certain point, in the 'thirties and has been again, since the war. During the trade depression of the 1930s Great Britain negotiated with the Scandinavian countries agreements under which they undertook to import certain quantities of British coal in exchange for some of their exports to the British market. These agreements had, let us admit, certain disadvantages. Polish coal, which would otherwise have looked for an outlet in Scandinavia, was diverted elsewhere—to the Mediterranean in particular—and competed with British coal more intensively in these other markets. The additions to Scandinavian purchases of British coal were not net additions to total British coal exports. But Great Britain did as a result of the agreements export during the years of depression substantially more coal than could have found an outlet without them.

'Ah, yes,' it may be said, 'but this gain was at the expense of Poland.' I am not sure of that; for the maintenance of British imports from Scandinavia made possible a larger total of foreign trade than would have existed otherwise. But, to the extent to which British did displace Polish coal, is Great Britain to be blamed? The British people could not go on importing goods for which they could not afford to pay: in order to import, they had to have markets for exports. If the total world market was too small to keep the world's productive capacity adequately employed, the remedy was not for Great Britain to maintain an unbalanced position by going on paying for imports by reducing its holdings of overseas investments, but for the world to take steps to achieve fuller employment by expansionist national and international policies designed to enlarge the total market.

Still less can the British people be expected, in face of the loss of a large part of its foreign investments and of the new debts which it has been compelled to incur during and since the war, to reconcile itself to a situation in which the only alternative will be to cut down imports at the cost of lowering the British standard of life. No doubt, this alternative would have to be accepted if there were really no other; but if Great Britain can arrange to receive additional imports in exchange for British products which could not be marketed abroad except on a basis of mutual exchange, can British statesmen be expected to forgo such 'swops' merely on the ground that they run counter to the American view of the principles on which foreign commerce ought to be conducted? The Americans cannot possibly show—because it is not true—that such practices

will restrict the total volume of world commerce. They cannot even show that the United States will be disadvantaged by them—except on the extraordinary assumption that it does not matter how large the American export surplus is, because the Americans will always be prepared to give away or to lend to other countries all the money needed for buying it, and that other countries, if they are offered loans instead of gifts, will be prepared to accept them on the required scale, with the effect of adding to their future obligations. This is lunatic economics; and yet it appeared to be the basis of long-term American policy in the field of international trade during the critical years before and after 1945, when post-war monetary and commercial policies were being laid down. Since then the Americans, in face of sharp realities, have been forced to modify their attitude; but these same assumptions seem still to underlie their long-run notions.

The important thing is, not to avoid bilateral arrangements altogether, but to use them when they are needed in such ways as to promote, instead of restricting, international trade. The situation sometimes imagined by economists, in which the whole world is regarded as a single economic area, within which not only goods but also human beings and capital migrate freely, moved by purely economic considerations and in entire disregard of territorial frontiers, never has existed, and is certainly not likely to exist in any near future. Men are not moved by purely economic motives in deciding where to live—when they do decide at all: nor are most men really free to move at will over the earth, in search of economic advantages, under any social system the world has known as yet. It cannot be a matter of no account to a country if, on purely economic grounds, its population ought to be moved *en masse* elsewhere, or if it must submit to a lower standard of living because total *world* wealth might be greater if industry and people deserted its territory. Perhaps, some day, territorial frontiers will be done away with, and a World State will be born. But, even so, will it become a matter of no account to Englishmen if England lose its prosperity? It is not so to-day with the people of Northern Wales or of the Scottish Highlands—or indeed with *any* people. The throwing down of territorial frontiers between States would not make an end of national or local sentiment: nor could a World State afford to ignore the well-being of each of its parts in pursuit of a programme of maximum production over its whole territory. Countries have to think of their own well-being, as well as of the world's; and it is most unlikely that a world Government which ignored the welfare of individual

countries in order to maximize world production as a whole would last long enough to know that it had failed in its purpose.

This is not to suggest that migration may not be beneficial. Clearly it may, especially where there is a sharply rising survival rate and a pressure of population on the land. But it is one thing to encourage voluntary migration, and quite another to expel populations from their homelands by the pressure of economic forces without an attempt to stem their current. Economic progress involves continual adaptation; but there is a limit to the pace at which countries can adapt themselves without social disaster. Nations have a right to protect themselves against world forces whose impact is too powerful to be met by reasonable measures of adaptation. This is the fundamental case for some sort of 'protectionism' in a world of change: it is the case which the *laissez-faire* dogma does not meet, but simply ignores.

Let us agree that 'protectionism' is very open to abuse, especially where there are powerful vested interests which seek it, not for the community's sake, but their own. But the admission that abuse is easy is an argument, not for giving up an objective, but for pursuing it better, to serve the ends of the people. It will be necessary, if quotas, licences, bilateral arrangements, and exchange controls are to be admitted as part of the normal processes of international trade and economic relations, to ensure that what is done in these ways is done in accordance with the requirements of a clearly conceived national economic plan of production and trade, made not in isolation, but in close consultation with other countries equipped with similar plans, and made in such a way as to bring about the largest possible measure of international co-operation between the planners of the various countries.

What Great Britain cannot afford to do, in this field any more than in that of the fixing of currency values, is to give up its freedom of national policy-making, and to surrender itself to a system of world *laissez-faire*, which under existing conditions is bound to mean American domination. Yet this is what Great Britain and other countries are continually being asked to do, merely on the *obiter dictum* of wealthy Americans that this is the way to maximize welfare, or on the assurance of American business interests that they will behave nicely if only other countries, and especially Great Britain, will join hands with them in making the world safe for 'private enterprise' against the threatened intervention of Governments in the sphere of international trade.

The future trade of Great Britain is best envisaged as resting on a foundation partly of unorganized 'free' sales and purchases between individual sellers and buyers in different countries, but also partly on organized bargains for the bulk purchase of necessary imports in exchange either directly for particular British exports or indirectly for more diversified exports through credits opened in Great Britain in favour of the suppliers. Such a mixed system offers great advantages. It makes possible a steadying of the market for bulk imports by means of long-term contracts which will enable the supplying countries to plan well ahead. It should steady both prices and output for the goods to which it applies; and it should give the suppliers the assurance of getting paid for their wares in goods they really want, at prices which they will have a share in deciding. This system need not extend over more than a fraction of total import and export trade; for a large unplanned margin is essential to the successful working of a system of planned bulk imports and planned sales of bulk exports in exchange. Over how large a part of the total field such arrangements should extend, or to how many countries they should be applied, who can profess to say? The essential thing is that Great Britain shall enter into no binding long-term trade or monetary bargains with the Americans that will make such experiments impossible without breach of international undertakings.

There is no need to repeat here at length the arguments I advanced more than ten years ago. It is enough to recapitulate very briefly.* On the average of the years 1936–38, British *net* imports were valued at £866 millions, and British net exports at £478 millions. The visible adverse balance was £388 millions. Interest and dividends on overseas investments reduced this deficit by about £203 millions, and shipping and financial services by another £145 millions, leaving a net deficit of about £40 millions to be met by borrowing or repatriation of overseas capital assets. These imports consisted mainly of foodstuffs and of materials and intermediate products needed for industry, finished manufactures making up only quite a small proportion. Since 1938, a large part of the revenue from overseas investments has disappeared, and a large amount of new foreign debt has been incurred. Moreover, at pre-war prices imports were cheap in relation to exports (that is, in technical phrase, the terms of trade were favourable). They have been much less favourable since 1945, for both foodstuffs and raw materials. From a world

* For the full argument, see *Great Britain in the Post-war World* (Gollancz, 1942).

standpoint this is a good thing, for many of the world's primary producers have been grossly exploited and ought to get better relative prices; but it means that more British exports are needed to pay for imports of the pre-war volume. The increased exports require more imported materials; for up to a third of the value of exports, except coal, may be made up of the things imported for making them, and not of the value added in the course of manufacture in this country. Add to this that full employment and social security both mean an additional demand for materials for use in industry, and more consumption of foodstuffs and other commodities. It was by no means an exaggeration to suggest in 1942 that Great Britain would need after the war, apart from any provision for the export of capital, to raise net exports from £478 millions to £1,000 millions at 1938 prices.

A good many years have passed since I began arguing the case for planned as against planless international trade and urging the importance of keeping a free hand for such planning against the devotees of unregulated capitalist enterprise. Since the early years of the war I have continually linked this insistence to an attempt to make the British people aware of the full seriousness of their international economic problems. When I argued in 1942 that in order to maintain the British standard of living it would be necessary at least to double pre-war exports I was widely accused of extreme exaggeration—an increase of 50 or 60 per cent. being then commonly regarded as likely to be ample to meet the need. I kept at it, and it has long been fully shown that I was right. The quantum of British imports since the war cannot be exactly compared with the pre-war quantum, the basis on which the statistics are compiled having been altered. It is, however, safe to say that up to 1953 the post-war quantum had even approached that of 1938 in only one post-war year, 1951; and in that year the deficit in the balance of payments, which had been eliminated in 1950 at the cost of a considerable fall in stocks of imported goods, soared to an immense height. The high imports of 1951 were in fact largely due to the accumulation of stocks which followed the war scare created by the outbreak of fighting in Korea. They were quite abnormal. In other post-war years until 1953 the real level of imports has been a long way below that of the years before 1939. Yet even at this reduced level there has been, despite American aid, great difficulty in paying for imports, especially in dollars, despite an increase in the quantum of exports, which by 1950 had risen to about 60 per cent.

above the level of 1938—though it fell again in 1952–53 to about 50 per cent. above that level.

Up to 1951 British exporters enjoyed, in general, the benefit of a seller's market. They were able, broadly speaking, to sell at remunerative prices all they were able to supply—though export sales were not always so profitable as sales in the home market. After 1951 world markets for manufactured goods became much more competitive as many countries restricted imports in order to cope with crises in their balances of payments, and as Germany and Japan began to come back seriously into many parts of the market. In face of this situation, with American help being rapidly curtailed and a total end to it threatened in the near future, it was absurdly optimistic to suppose that in a world market subject to American dominance Great Britain could expect to escape from its difficulties in balancing its international payments without taking special measures to secure as many as possible of its necessary imports from sources which would take British goods in exchange for them. It could not be done, even if over the world as a whole most countries were actively following policies of full employment on a basis, not of economic nationalism, but of a ready willingness to collaborate with other countries in raising the level of international trade, and if, further, no adverse influences appeared in the United States. But who can rely on all these conditions being fulfilled? Even the first of them stands no chance of being fulfilled unless in most countries the State not only takes an active part in national economic planning and also enters into mutual relations for international planning—that is, for assured bulk exchanges of goods and services with other countries. An *element* of what is called 'bilateralism' is, in fact, inherent in planning as soon as it transcends the purely national scale. It would be a sorry outcome if planning were to be forced on to lines of national *autarkie* because it had to exist in a world framework which excluded all agreements between nation and nation, in the name of an illusory world-wide freedom of exchange.

The argument becomes even stronger, from the British standpoint, if Great Britain is to be expected in future to play an active part in the export of capital for the economic development of the economically backward countries. How can Great Britain export capital until British imports have been fully paid for with exports and until provision has been made for the repayment of British overseas debts? The export of capital implies a surplus of exports over imports, including 'invisible' items on both sides of the

account; but Great Britain can hope for such a surplus only after the formidable task of doubling pre-war exports has been successfully tackled. Great Britain cannot afford to export, as capital loans, goods which the purchasers would buy and find means of paying for if the loan were not granted from British sources. Great Britain needs to get paid currently for what is exported up to the point necessary for balancing the international accounts. No doubt, Great Britain has been making overseas loans and gifts during the years since 1945 despite the existence of an unfavourable balance of payments; but this has been done either out of American gifts or by incurring additional long-term or short-term overseas debts. Even if the Americans were to be willing in the future to lend money to Great Britain for foreign investments designed to stimulate demand for British exports—an improbable supposition—is Great Britain in a position to incur further debts to the United States with any real prospect of paying them back?

It all comes to this. Bilateralism is not, up to a point, a bad or a restrictive thing, as some economists have tried to make it out. It can be used to expand trade, as well as to restrict it; and in difficult times, it is likely to have considerable merits as an instrument of expansion, or at least of defence against the contraction of international trade. It would be exceedingly foolish on the part of British statesmen to tie themselves down in such a way that they could not make use of it. It is easy enough for the Americans to denounce as 'discrimination' practices which the state of their own balance of payments gives them no inducement to pursue. But often the real motive is not the avoidance of 'discrimination', but the putting of barriers in the way of state trading, or of active state intervention in regulating the course of international trade. Governments which purpose to pursue policies making for full employment cannot afford to divest themselves of the power to plan internationally, as well as on a national basis; for their plans must cover imports and exports, as well as home production for home use. Let us by all means keep on our guard against restrictive forms of bilateralism, and against the making of bargains to suit vested interests rather than the common people; but let us not fall into the trap of accepting, in the name of 'multilateralism', a set of rules which will make it impossible for us to maintain our imports at the level needed to secure our standard of living, or to plan for full employment on the basis of a satisfactory division of labour.

XIV

FOREIGN INVESTMENT AND THE DEVELOPMENT OF BACKWARD COUNTRIES

We may now consider the problems of long-term investment of capital across national frontiers. When capital is lent from one country to another, the effect is to transfer purchasing power from the lending to the borrowing country. The loan may be made in the currency of either country, or even, occasionally, in that of a third country. If it is made in the currency of the lender, and if the money is spent on buying goods in the lending country, no monetary problems arise, except that of paying for imported materials incorporated in the goods and for the services of foreign transport agencies, if they are used in moving the goods. Apart from these items, the loan goes out in goods, and no money, apart from the goods, need leave the lending country. This, however, hardly ever happens in full. The borrowers of the capital are pretty sure to want to spend at least part of it in buying goods and services in their own country, and probably another part in buying goods from other countries. They will therefore wish to turn some of the loan into their own currency and some into the currencies of other States. If the loan is raised in the currency of the borrowing country, there arises at once the 'transfer' problem of turning the lenders' into the borrowers' money, though some of it may be turned back again if part of the loan is spent on goods made in the lending country. If it takes the form of a credit in the currency of the lending country, the part of the credit that is not taken out in goods or services will need to be exchanged for some other currency—that of the borrower, or those of other countries from which goods or services are bought with the proceeds of the loan.

Thus, the export of capital involves a pressure on the exchanges of the lending country, to the full extent to which loans are not spent in buying goods made within it of home-produced materials or services rendered by its nationals at home. It follows that a country can afford to export long-term capital only to the extent to which it either (*a*) has already a surplus of exports over imports, including the 'invisible' items on current account, or (*b*) can so arrange the loan that it is supplied in the form of goods and services

from the lending country, or (*c*) can borrow the capital from some other country, and then re-export it.

What sometimes happens is that a country makes long-term loans out of short-term funds belonging to foreigners which have been deposited in its money market. It is then said to be 'borrowing short and lending long'—a dangerous practice, because the short loans may be recalled long before it is possible to get back the capital lent at long term. Great Britain was caught in this way in 1931, not so much because British financiers had been deliberately re-lending short-term funds at long term as because loans which had been supposed to be revocable at short notice (e.g. loans to Germany) turned out not to be revocable on account of the slump. Indeed, the Germans had been re-lending at long term part of the short loans they had got from Great Britain and America; and when Germany blocked re-payment of these sums, the original short-term lenders found themselves converted against their will into lenders at long term.

Long-term foreign loans ought, then, to be made out of capital which the lenders are free to lock up over a considerable period. It does not, however, follow, because an individual or company wishes to make a long-term loan or investment and feels able to lock the money up, that the country to which the would-be investor belongs can afford to let him or it invest in foreign long-term capital. That is where foreign differs from home investment. There is no necessary relation between the volume of home savings looking for investment and a country's capacity to invest abroad. When a country, or any person or company within its frontiers, sets out to use a part of its capital for foreign investment, the State or the Central Bank of that country has to assume the burden of providing, in exchange for the home currency, such foreign money as the investment may require. The supplies of foreign money that can be made available for this purpose do not depend at all on the amount of saving that is being made in the country concerned: they depend on the state of its balance of payments, which is an entirely different matter. If a country's exports, including invisible exports on current account, exceed its imports, similarly including the invisible items, a short-term export of capital is actually taking place, whether anyone has planned it or not. If this occurs on a scale which exceeds the willingness of the country and of its nationals to make *long-term* investments abroad, the effect is that its banks make, willy nilly, short-term foreign investments, by becoming holders of

foreign currencies in the form either of balances in foreign banks or of short-term money market investments abroad. Such balances can be liquidated in gold, if the countries which owe them are in a position to sell gold for this purpose. Or they can be used in buying goods for import into the creditor country. If they are not so liquidated, they cannot be met at all; and the sums in question must either continue as short-term balances abroad, and be renewed from time to time where renewal is required, or be converted into long-term foreign investments.

This, however, is not a complete statement of the position. If a country has a favourable or an adverse balance of current payments, the state of its balance will not be affected by lending capital abroad —provided that the entire loan of capital goes out in the form of additional goods and services produced in the lending country. This means that (*a*) a creditor country cannot dispose of a favourable balance by exporting capital, if the export is made in its own products; for such exports will enter into the account on both sides, and will leave the balance unaffected; (*b*) a debtor country can export capital, even if it has an unfavourable balance of current payments, to the extent to which it can send out additional exports in the form of home-produced goods. True, such a country may show no *net* foreign investment; for its export of capital will be set against its deficit on current account in making up the final figures; but it may none the less be lending capital to some countries while it is borrowing from others. Germany, in the pre-Nazi period, was making considerable capital loans to Eastern Europe, and at the same time had in many years a deficit on its current account and was borrowing large amounts of foreign capital—which were indeed the source of its ability to make capital loans.

This was possible for Germany, before the slump of 1931, because the German banks were able to borrow foreign capital and use it for re-lending. Apart from such capital loans, it is never in fact possible for a country which is in deficit on its current payments to leave its foreign exchange position unaffected by exporting capital, because capital exports never go out *entirely* in the form of additional goods and services produced in the lending country. Even when the whole or a substantial part of the loan is 'tied', so that it can be spent only on products of the lending country, these products will necessarily incorporate some materials produced elsewhere; and a part of the loan will in most cases be used to cover freight charges, not necessarily for transport in the ships of the lending country. A foreign

loan, however much it may be tied, will practically always mean *some* claim on the banks of the lending country for additional foreign exchange, and will thus tend to impose some net burden on its exchanges.

Of course, this principle applies also in reverse. If a country with a favourable balance of payments on current account makes a long-term loan and ties it so as to make it usable only for the purchase of its own products and to insist on these goods being carried in its own ships, nevertheless there will be *some* imported materials contained in the finished goods exported as a consequence of the loan, and accordingly some part of the loan will go towards reducing the favourable current balance. But, especially when the country in question uses mainly home-produced materials, the part spent on foreign goods may be very small. It is peculiarly unfortunate when countries with favourable current balances insist on 'tying strings' to their loans, and thus prevent more than a tiny fraction of them from going towards squaring their international accounts. Yet this is precisely what the United States has a habit of doing—for example, in the case of loans made by the Import-Export Bank.

There is a further complication. In what has been said so far, it has been assumed that when goods are bought out of the proceeds of a foreign loan, the sales so made are *additional* sales, none of which would have been made had there been no loan to finance them. In practice, however, in most cases *some* of the purchases made with the aid of the loan would have been effected without it, and the net result in terms of additional purchases is smaller than the amount of the loan. This applies especially to purchases by countries which are short of foreign exchange. If a country which is in deficit on its current balance of payments makes a foreign loan, a part of the effect will be that it will not get paid for exports which would have been sold and currently paid for if the loan had not been made. This may put narrow limits on the ability of a country which has a current deficit to make foreign loans; for, if it does so, its balance will be worsened in three distinct ways: (*a*) by the spending of any part of the loan in such a way as to set up a direct demand on the lending country for additional foreign currency; (*b*) by the necessity of paying for the additional imports of materials used in producing the home-manufactured goods on which the loan is spent; and (*c*) by the loss of foreign currency receipts from the sale of goods which would have been bought and paid for in the absence of the loan.

We have seen that, when foreign investments are made by a

country or by its nationals, the Central Bank of the country has to provide whatever foreign currencies may be needed as a consequence. If a country is short of foreign exchange, the Central Bank may not be in a position to do this; and accordingly, as we have seen, countries resort to various methods of checking or controlling foreign investment by their nationals.

For some time to come, the only country with a large surplus of foreign exchange arising out of current transactions, and therefore available for investment overseas, will be the United States. But there are countries which emerged from the war as holders of large balances due to them for goods and services supplied by them during the war and not paid for then in either goods or gold. The countries in question—India above all, a number of States in the Near and Middle East, Australia, Canada, some of the States of Latin America, and some of the British colonial territories—were paid for these goods and services only in the sense that they were credited with the sums due to them in the currency of the country that bought the goods. Such 'sterling balances' held in London could not be used for buying goods or services except to the extent that they were specially released for such purchases. Great Britain emerged from the war with a huge mass of sterling debt which, in face of the adverse balance of current payments, it was out of the question to repay, save very gradually, either in British goods or by allowing it to be exchanged for other currencies, so as to be used for buying goods and services elsewhere. These 'sterling balances' had to be 'blocked' for the time being, and sums released out of them only in response to urgent demands from the countries concerned. Great Britain was pressed by the Americans, when Lease-Lend was being wound up and a loan from the United States was being sought in 1945-46, to reach an accommodation with its sterling creditors, under which part of these debts would have been written off.* But the countries in question—many of them poor and in urgent need of capital for development as well as in difficulties over their current balances of payments—not unnaturally refused to reduce their claims and preferred to accept the continued blocking of payment, subject to agreement gradually to release the money over a period of years.

Accordingly, since the end of the war, Great Britain, despite its

* It should be noted that one of the explicit conditions attached to the American Loan to Great Britain in 1946 was that it should not be used for repayment of sterling balances accumulated during the war. See page 188.

adverse balance of payments, has been gradually paying off these wartime debts. But in spite of quite large repayments, the total sterling balances were higher by £500 millions at the end of 1953 than they had been in 1945. In every year since the war, except 1948 and 1952, their total amount increased. New sterling debts accumulated faster than old ones were paid off. There are several reasons for this. In the first place, the countries of the sterling area, except South Africa, keep most of their gold and dollar reserves in Great

TABLE XXV

STERLING LIABILITIES OF THE UNITED KINGDOM, 1945-1953

	End of Year: £ Millions								
	1945	1946	1947	1948	1949	1950	1951	1952	1953
To U.K. Colonies .	447	495	502	556	582	754	968	1,076	1,161
To Other Sterling Area Countries .	2,007	1,922	1,786	1,809	1,771	1,980	1,825	1,606	1,774
	2,454	2,417	2,288	2,365	2,353	2,734	2,793	2,682	2,935
To Dollar Area .	36	35	21	19	31	79	38	34	62
To Other Western Hemisphere Countries . . .	164	213	235	135	80	45	57	6	40
To O.E.E.C. Countries . . .	421	424	481	370	439	395	409	321	305
To Other Countries	613	632	572	531	514	492	514	394	366
To Non-territorial Organizations .	—	26	388	398	576	577	566	567	509
Total . . .	3,688	3,747	3,985	3,818	3,993	4,322	4,377	4,004	4,217

Britain, as part of a common sterling area reserve which Great Britain administers on their joint behalf. This means that any improvement in their balances of payments increases Great Britain's sterling liabilities to them and, if the improvement is in their balance of payments with the dollar area or with other 'hard currency' countries, at the same time adds to the British—which is in fact the sterling area's—gold and dollar reserves. Thus, an increase in Great Britain's sterling liabilities is not an additional burden as far as it is offset by an increase in gold and dollar holdings. As sterling area

countries have restored their reserves held in London against their own currencies, Great Britain's sterling debts have increased correspondingly. In fact, however, at the end of 1953 Great Britain's gold and dollar reserves, measured in U.S. dollars, were only a little larger than at the end of 1945—$2,518,000,000 as against $2,476,000,000. They had been much higher: in June 1951 they stood at $3,876,000,000, mainly as a consequence of the large payments made by the United States for materials as a result of the forcing up of prices arising out of American stock-piling in connection with the Korean crisis. But thereafter they melted rapidly away as British purchases of materials and foodstuffs at high prices in 1951 brought about a great increase in Great Britain's own adverse balance of payments and as certain other countries, notably Australia, also drew heavily on the common reserve. These heavy drawings led to the financial crisis of 1951 and to the severe curtailment of imports which followed. The drawings of the entire sterling area on balances in London had to be severely restricted, especially where payments in gold or dollars were involved. In effect, in 1951 Great Britain, though not the only offender, had been using the gold and dollar reserves of the whole area to meet its own demands for imports. In part, this meant that gold and dollar holdings were replaced by increased holdings of stocks of materials and other goods; but as these had been bought at inflated prices and there was a large subsequent fall in the prices of many of the materials in question, the cover was inadequate. Moreover, a part of the spending had been on high-priced imports for current consumption. In 1953 the reserves mounted up again; but at the end of the year they were approximately back only to the level of mid-1950.

To the extent to which increased sterling liabilities were not offset either by increased gold and dollar reserves or by stocks of materials at realistic values, Great Britain's true liabilities were increased. It can be seen from the Table that at the end of 1953 total sterling liabilities were about £300 millions higher than at the end of 1949, whereas the gold and dollar reserve was higher by nearly the same amount. But the composition of the liabilities had altered. Liabilities to British Colonies had increased from £582,000,000 to £1,161,000,000, whereas liabilities to other sterling area countries were practically unchanged at £1,774,000,000, and there had been a fall of £290 millions in liabilities to non-sterling area countries. This change was largely the result of the large sums received by the Colonies—especially Malaya—in payments for materials bought at

high cost by America during the boom; but it led to a most curiously paradoxical situation. One would expect the colonial areas, which have low standards of living and are in great need of capital for economic development, to be large importers of capital from the more developed countries. In fact, however, despite the sums spent on colonial development, they have been large net *lenders* of capital to Great Britain, which has been using their money to meet its own balance of payments difficulties. Of course, the sums thus borrowed from the Colonies will have to be repaid—except as far as they are kept as reserves against colonial currencies. But in the meantime they are diverted from spending on colonial development.

The case advanced in defence of this curious position is that it would have been a mistake to allow the windfall profits of the boom in prices of colonial materials to be paid out in higher immediate purchasing power to the colonial peoples, because the consequence would have been an inflation and a sudden rise in consumption that could not have been sustained when the boom was over. It was held to be better to accumulate a large part of the windfall in reserves against a possible collapse in material prices. In addition, it was argued that it would have been impracticable for the Colonies, even if they had wished to use the large sums accruing to them for capital investment rather than for increased consumption, to get the needed additional supplies of capital goods and competent technicians or suddenly to scale up their investment programmes without causing an inflation in their internal affairs. There was substance in these arguments; but clearly the Colonies, as well as other economically undeveloped areas, are in need of all the capital they can get for investment in improving their productive resources, and it is a startling anomaly that instead of importing capital they should be in effect lending it to Great Britain. Such a situation cannot last: the sums borrowed from the Colonies in the form of increased sterling liabilities will have to be speedily paid back, even if the British balance of payments remains under serious strain.

This, it may be said, is primarily a problem not of investment, but of the migration of short-term funds. But that is hardly the case. Certainly, as far as India—the largest sterling creditor—is concerned, the best use that could be made of the accumulated balances would be to apply a large proportion of them to purposes of long-term investment in capital goods to be produced in Great Britain, in such a way as to minimize the exchange difficulties involved in their transfer. Such a policy would enable the British

Government to release the money more rapidly than if it were to be spent on foreign goods, and would thus help to speed up the economic development of India. But no such policy can be practicable unless Great Britain is in a position to make arrangements for liquidating these obligations in kind, and is protected against unlimited demands for freedom to transfer the funds to purchase goods anywhere in the world, irrespective of the British shortage of foreign exchange.

Much larger issues arise in connection with the more general problem of long-term investment in the backward countries. If these countries are to get rid of their difficulties of agrarian overpopulation and are to have a chance of raising their economic efficiency to a reasonably high level, they will need very large quantities of capital goods * for which they cannot possibly pay with current exports until time has been allowed for their productivity to be greatly increased. Accordingly, they will need large foreign loans of long-term capital. Whence are these loans to come?

The obvious source for most of the capital needed for this purpose is the United States, which is the great 'surplus' country. The United States, as the chief creditor nation and as a great exporter, is in a position to buy from the rest of the world a much larger quantity of imports than it has hitherto shown any willingness to buy; and this disparity is likely to go on increasing unless American commercial policy is changed much more drastically than it has been so far. American unwillingness to increase imports up to the level of external purchasing power is due partly to the large native resources of most materials available for American industry and partly to the American tariff, which is defended both by powerful business interests and on the plea that it is necessary to protect the 'American standard of life' against the competition of low-wage products made in other countries. It seems most unlikely that the Americans will consent to lower their tariff to the extent that would be necessary to absorb the 'surplus' in increased imports; and it is even very doubtful whether so unlikely an event as the entire abolition of the tariff would achieve this result. Of course, the more

* In addition, as the capital works made possible by the loans will be mainly carried out in the borrowing countries and will thus cause large additional sums to be paid out in incomes to their own peoples, and as part of the increased incomes will be spent on imported consumers' goods, the effect of foreign investment will normally be to increase imports of consumers' as well as of capital goods.

the Americans are prepared to lower tariff duties and to accept imports of foreign manufactures, the better for the world as a whole; but that is their affair, about which no one is in a position to dictate to them.

As long as the 'surplus' remains,* the Americans can dispose of it in only four ways. They can import gold, as they in fact did on an enormous scale until most countries had no more gold to send, and have been doing again recently by importing newly mined gold; or they can invest it at long-term, either by buying up holdings in the long-term securities of other countries, or by starting new businesses, or subsidiaries of American businesses, abroad, without sending out additional exports on a scale sufficient to cover the loans; or they can lend 'short', for the most part by leaving the surplus uninvested and earning little or nothing in the countries where it arises; or they can go on giving it away. In the 1920s the Americans in the main 'lent long': that is to say, they acquired a considerable ownership of foreign long-term securities, especially in Germany, but to some extent in nearly all countries. In the course of the world economic crisis, many of these investments lost their value, and new long-term foreign investment was practically wiped out; nor did it recover on any substantial scale throughout the 'thirties. Consequently, when the American 'surplus' again grew large after the passing of the worst of the slump, the Americans, in addition to importing vast quantities of unwanted gold, 'lent short' on a large scale, leaving in other countries credits which they were not prepared to convert either into goods for import to the United States or into long-term foreign securities. This short lending had most unfortunate effects. The countries in which the money was deposited had no assurance of retaining it, and could not safely use it for long-term investment; and in most cases it was not needed in the short-term money market. It had to be sterilized—in Great Britain, through the Exchange Equalization Fund. The effect of this was the same as that of a deflationary banking policy in internal affairs. A substantial part of the world's purchasing power, instead of being used to buy currently produced goods and services, was being locked away idle, mainly in gold holdings either in the United States or in the various Exchange Equalization Funds.

After the war, the same dilemma again confronted the Americans. They began by lending, especially to Great Britain. The American

* I.e. unless the Americans get rid of the surplus by deliberately reducing their exports.

Loan of 1946 was used to sustain at a central point not only the British economy but also the economies of continental Europe, to which a good deal of it was in effect passed on. The Americans then hoped that the loan would serve to allow the countries adversely affected by the war—and especially Great Britain—to restore their economies and balances of payments. But in fact the loan was speedily swallowed up; and even if the Americans had been prepared to lend more, neither Great Britain nor any other European country could have afforded to go on borrowing at the cost of adding to future burdens. The Americans accordingly resorted, under the Marshall Plan, to outright gifts, in the hope that these would lead to a speedy enough recovery to enable the recipient countries to put their houses in order. This did not happen, save to a very limited extent; and presently economic aid was succeeded by military aid. This latter, from the standpoint of achieving European recovery, was largely self-defeating, because it imposed on the recipient countries costs for re-armament which they were ill able to bear. Re-armament, apart from its financial burdens, made demands on just those productive resources which were most needed for supplying capital goods for economic restoration and development. Countries could not at one and the same time re-arm heavily and put their economic houses in order. Capital investment, especially in Great Britain, had to be slowed down in order to give the required priority to arms production; and the countries which diverted a large part of their productive resources to re-armament were faced with the prospect of a crisis the moment the Americans cut off or seriously reduced their aid.

Only a very large investment of American long-term capital in European industry, steadily sustained over a long period, could have made European economic recovery compatible with intensive re-armament. But even this would have involved a parallel increase in Europe's dollar obligations for interest on the sums invested—a charge which could not have been met without an American readiness to accept a greatly increased volume of European manufactured imports—apart from the fact that European countries are naturally reluctant to see the ownership of their productive resources fall more and more into American hands. The objection to this is strong even in countries which show no disposition to follow policies of socialization—policies to which foreign ownership would evidently present serious obstacles. To countries such as Great Britain, in which a Socialist Government was in office during the

critical post-war years, the prospect of having American investment in industries it might be desired to socialize was still less pleasing. The Americans, however, save in certain special cases, such as oil refining, showed no disposition to make large private capital investments in Great Britain—or indeed in most parts of Western Europe. They altogether failed to face the problem presented by their large excess of exports and receipts from existing investments over their imports, save by the temporary expedient of making outright gifts.

It was one of the main features of the Keynes Plan of 1943, which will be considered later, that it brought out the point that there could be 'bad' creditors as well as 'bad' debtors. If it is an offence to the rest of the world for a country to run into debt and to be unable to meet its external obligations, so that it has in one way or another to 'bilk' its creditors, is it not also an offence for a country, by refusing to exercise a part of its international purchasing power, to inflict serious hardships on the rest of the world? It may be said that other countries are under no obligation to buy American goods, and that if they did not the American export surplus would no longer exist. But as matters stand other countries cannot do without American goods and other goods for which payment has to be made in gold or dollars; and when they try to replace such goods by supplies for which they can more easily pay—e.g. Rhodesian instead of Virginian tobacco—they are at once accused of 'discriminating' unfairly against the United States. It is true that, on plea of post-war emergency, the Americans have put up with a good deal of 'discrimination' (and have practised in various forms a good deal themselves). Nevertheless, they have continued to argue that every discrimination must be removed with the shortest possible delay, and that the pattern of world trade for the future must entirely exclude such practices.

It can be said, too, that since 1945 the Americans have been very generous in making outright gifts which have made it possible for other countries to go on buying American goods on a much larger scale than they could have done without such help. That is entirely true—though in recent years they have attached such 'strings' to their help, in respect of both re-armament and political policy—as to render it a more than doubtful benefit. What they have not done, and apparently will not do, is to adopt the trade policies which are appropriate for a great creditor country, by admitting imports freely, as Great Britain did in its creditor days, and thus enabling

other countries to receive United States products in exchange for their own.

Such a change in United States policy would of course encounter very bitter opposition from many vested interests, not excluding some of the American Trade Unions. Even a most determined President would have the greatest difficulty in persuading even the most liberal Congress it is possible to imagine to accept it. This is partly because the United States Congress is so composed as to place very great opportunities at the disposal of pressure groups, and partly because the Americans have developed a political habit of yielding to such groups and indeed of shaping political conduct in terms of rival pressures. No doubt, the Presidents, under the special powers conferred on them during the emergency to negotiate reciprocal tariff concessions, have done something towards liberalizing some features of the United States tariff. But these modifications have not gone far enough to make a great deal of difference in relation to the size of the gap that needs to be filled. Nor, I think, does anyone really expect any very big change in American trade policy to be made, in face of the obstacles, for a long time to come.*

I have said already that I doubt whether the gap would be filled even if the United States ceased to have any tariff at all. On the whole, Americans prefer their own goods, apart from a limited range of European specialities—and of course apart from such materials as they cannot produce enough of at home. Nevertheless, a drastic change in American tariff policy would reduce the gap considerably; and, sometime, the change must be made if the United States is not to cut down its exports far below the existing level. The only other alternatives are either a continuance of the policy of giving the surplus away—which Congress would certainly refuse to endorse—or an expansion of long-term overseas investment on a scale that would face the recipient countries with an insoluble problem in meeting the interest charges unless these could be met regularly out of fresh American investments. This last amounts to the Americans never being paid at all, except by themselves; and it would mean that any falling off in the amount of American overseas investment would immediately cause a financial crisis in all the recipient countries.

One of the aims of the Keynes Plan† was to induce any 'surplus'

* On this point, see further page 400, where the course of events subsequent to the Randall Report of January 1954 is discussed.

† See page 339.

country to make use of its current balance either in buying additional imports or in long-term foreign investment. Under the Plan a large part of the 'surplus', instead of lying in the short-term money markets of the world, would have been converted into a credit balance in the books of the proposed International Clearing Union, where it would have been exactly offset by debit balances of other countries. In effect, the credit mechanism of the proposed Clearing Union was a device for lending the current American surplus to meet the needs of the 'deficit' countries. This, however, would not have meant that all would have been well; for the 'deficit' countries would have wanted, as soon as they could, to cease being 'deficit' countries either by expanding their exports to cover the cost of their imports, or by borrowing long-term capital from abroad. The Keynes Plan embodied an attempt to bring pressure to bear, not only on 'deficit' countries to reduce their debit balances, but also on 'surplus' countries to get rid of their credit balances in the Clearing Union either by accepting more imports or by investing them in long-term enterprises in the 'deficit' countries.

The only positive proposal put forward for achieving this was that the 'surplus' countries, instead of receiving interest on credit balances which they failed to convert into long-term investments, should pay a charge upon them corresponding to the interest charged to countries which incurred foreign debts. In other words, credit balances should earn a *negative* rate of interest. This negative rate, which was to begin only when the balance of the country concerned exceeded a quarter of its total 'quota' as laid down in the Keynes Plan, was put at 1 per cent. on any balance exceeding half the quota. The same rates were to be payable by countries having debit balances, the price being paid in both cases by drawing on the balance held by the country in question in the books of the Clearing Union. That is to say, a 'deficit' country was to have its debit balance increased, and a 'surplus' country to have its credit balance decreased, by the amount of the 'fine' for departing from a position of international equilibrium.

It is very much to be doubted whether these small 'fines' would have had any considerable deterrent effect on any 'surplus' country. Nor, probably, was it desirable to make them heavier; for, even as they stood, they might have been unduly deterrent to a 'deficit' country which needed time for the adjustment of its economy. It would, of course, have been possible to make the 'fine' heavier in the case of the 'surplus' countries, while leaving it as it was or even

reducing it in the case of the 'deficit' countries. But this was presumably regarded as politically impracticable, and the equality of treatment as furnishing the only real chance of getting the proposal accepted. The vital point of the provision was, however, not so much the amount of the 'fine' as the recognition implied in it that creditors as well as debtors have responsibilities; and, if the Americans had been prepared to agree to it, the psychological effect might have been much greater than that of the 'fine' itself. But they would not agree.

One weakness of this part of the Keynes Plan was that it would have been open to the 'surplus' countries to get rid of their surpluses, not by accepting more imports or by buying long-term investments, but by reducing their exports or by continuing to import gold, which would not have appeared as a 'credit' in the books of the Clearing Union. If gold had been imported, the position would have been no worse than it has been in the past; but if exports had been deliberately restricted for the purpose of wiping out the 'surplus', the 'deficit' countries would have been deprived of badly needed supplies; and a stimulus would have been given to the forces of *autarkie* throughout the world. This potential danger was however, probably not one against which such a body as an International Clearing Union could possibly guard. How real it would have been would have depended partly on the tenacity of resistance in the 'surplus' countries to accepting additional imports and partly on the success of measures for promoting international long-term investment.

What, then, could be done with this latter purpose in view? One great difficulty in the way is that investment of capital at long term in foreign countries is not attractive unless three conditions are simultaneously satisfied. The economic prospects of return must be reasonably good; the political conditions must be such as to afford reasonable security for the money invested, and the investor must have a reasonable assurance of getting paid either in his own money or in money he can convert into it. How far is any of these conditions likely to be satisfied in the critical period which the world is facing to-day?

Take first the political condition of reasonable security. A private lender to the Government of a particular State or to any corporation or business inside its frontiers runs, unless he is guaranteed by his own Government, the risks of political instability in the country concerned. In the extreme case, if it should have a Communist

revolution, he incurs the risk of complete expropriation; and a much less thorough-going revolution may in practice result in the loss of his investment through the upset of the currency or at least in the 'blocking' of all returns upon it. Foreign bond-holders are accordingly apt to have a strong vested interest in the stability of any Government under whose auspices they have lent money, either to the Government itself or to any concern subject to its jurisdiction. This may be a very serious matter in the case of small or backward States, whose Governments, however unrepresentative, may be powerfully upheld by foreign investing interests. Apart from this, the risks of political instability must, in order to attract lenders, be compensated for in the rates of interest offered on the loans. When world conditions are unstable, or are deemed so by the financiers who organize foreign loans, the rates of interest charged to borrowers are apt to be raised to a level at which many potential loans of capital become too expensive to be profitably taken up, so that the rate of investment is slowed down.

The economic risks are not wholly separable from the political risks. Manifestly, the prospect of using capital at a profit is affected by the political state of the country in which the investment is to be made, as well as by its natural eligibility for economic development. The policy followed by the Government of the borrowing country affects the level and the distribution of purchasing power within its frontiers, and therewith the prospects of profit on enterprises designed to provide for domestic consumers' demands. Many investments are attractive from the standpoint of prospective profit only if other investments are made as well. For example, a railway will be profitable if capital is invested in developing the area through which it runs, a power-station if there are to be local industries to use the current it can produce, and so on. A concerted policy of investment in many forms of enterprise may increase the prospects of profit on each particular investment.

The third condition is under present circumstances the most difficult of all, unless the nature of the investment is such as to meet it. If the overseas investment is directed to the production of commodities which the *investing* country wishes to import more of, the interest on the capital can be paid in goods, or rather by the sale of goods in the investing country. This seems like an answer to the problem; but it involves serious disadvantages for the borrowing countries. These are forced, in order to get capital, to promise to spend it, not on the kinds of investment which they would prefer

in the interest of their own peoples, but on the kinds which suit the book of the capitalists in the investing country. In general, mining development, oil extraction, and certain sorts of plantation industry will receive preference over investments for the production of goods needed by the borrowing country, or for raising general standards of productivity in it. Investment under these conditions will tend to carry on the traditions of economic imperialism and to be pursued with little regard for the welfare of the peoples affected by it, and quite possibly to their detriment. Such investment, in these days, will encounter strong nationalist opposition in many countries; and this will add to its political insecurity.

These considerations point to the desirability of an investment policy in economically backward countries designed to keep interest rates down to the lowest possible level, and also to promote a co-ordinated programme of economic development, within which each enterprise will help to put the others on their feet. But there is not much prospect of finding private investors who will be willing, in face of the political and economic risks, to lend capital to the backward countries, except under very special circumstances, without charging rates of interest which it will for a long time be very difficult, or indeed impossible, for the borrowers to meet except out of further loans. Investors in foreign bonds are most easily tempted by high rates of interest, accompanied by considerable risks of loss or default, rather than by the offer of smaller, but better assured, returns on their money. If the returns actually received in the 'thirties on all the capital invested in foreign securities issued since 1929 were to be averaged, the rate of interest received by the borrowers would probably look modest enough. The investors actually got only a low return, on the average; but they were promised a high return, and some of them got a high return, while others not merely got nothing but lost, through a fall in the value of their holdings, a substantial fraction of the capital lent—or even the whole of it.

It would be infinitely better, instead of going back to a system under which each borrower of capital had to promise, and to pay if he were able, a high rate of interest, while the lenders got, on the average, a low rate of return after allowing for losses of interest actually paid and of capital value, to pool risks, and as far as possible reduce them, so as to lower the rates charged to borrowers without therewith diminishing the incomes of the investors, taken as a group. How could this be done?

The most straightforward way would be for the money to be lent, not by private investors, but by Governments acting through an international agency. As we shall see, this is to some extent what is actually being done through the International Bank for Reconstruction and Development set up at Bretton Woods.* But, though this Bank can make public loans for industrial development, it is expressly precluded by its Charter from setting out to supersede private investment: nor are its resources large enough to go more than a very little way unless it is able to tempt private investors into the field with much bigger funds than it can itself provide. Moreover, its loans require the guarantee of the Governments of the countries in which the investments are to be made. This saddles the Governments in question with financial responsibilities they are in many cases ill-equipped to assume.

Yet, it is not easy to see how else, under existing conditions, the loans are to be made. The International Bank for Reconstruction and Development is a valuable beginning; but it would be much more valuable if, instead of throwing sprats in the hope of catching mackerels of private investment, it became itself the main lender for approved development projects and raised the additional capital needed for this purpose from those who have money to lend, and might be expected to lend it more readily on the International Bank's guarantee. If private investors could lend their money, not to particular borrowers in the backward countries, but to an International Investment Corporation, or perhaps to a series of such corporations each acting in a particular functional field, and if, further, these corporations re-lent the money to Governments or enterprises in the backward countries in accordance with coherent and well-balanced plans of economic development, the capital could, without any element of subsidy, be made available at a lower rate of interest, which would both enlarge the demand for it in the areas concerned and yield the investors a secure return. Moreover, an International Investment Bank operating in this way could serve a most valuable purpose in helping to steady the volume of international long-term capital movements, and to check both speculative excesses and precipitate attempts to withdraw funds, such as occurred in 1929.

In general, some such structure as this, with a number of 'functional' investment agencies operating side by side and linked together by a general co-ordinating body under international con-

* See pages 402 ff.

trol, seems in the circumstances, with the commercially minded United States as the only available source of most of the funds required, to offer the greatest prospects of success in mobilizing the available capital of the more advanced countries for the development of the more backward. It must, however, be emphasized that no machinery can be effective for this purpose unless the capital is supplied to the borrowers at a cheap rate, when it is not given outright. The poorer countries cannot afford to be large borrowers at high rates of interest; and, if high rates are charged, all that will happen is that the enterprises selected for development will be not those which are most calculated to raise the productivity and the standards of living of the peoples of the backward areas, but those which the capitalists of the advanced countries wish to develop as sources of materials for use in their own industries. Disproportionate weight will be put on extractive industries, as against industries to produce cheap consumers' goods for the home markets of the countries concerned, or even industries designed to work up native raw materials to an intermediate stage; and nothing will be done to open up the countryside by transport, power and irrigation services, or to develop higher standards of agricultural technique. This is largely what has happened in the past. Too much of the capital invested in backward countries has been directed in the interests of foreign groups desirous of promoting a particular enterprise auxiliary to their own industries, and much too little to meeting the needs of local populations, or to fostering higher standards in native production generally.

For the future, if the Governments of the United Nations follow out the intentions which they have declared, the primary aim of international investment policy will be to promote better standards of nutrition and general living conditions in every part of the world, by means of a concerted international crusade against want. To proclaim such a purpose is not mere idealism; for it is at last coming to be widely realized that the possibility of employing to the full the productive capacity of the more advanced peoples depends on raising standards among the less advanced, so as to have continually expanding markets for the products of developed industrial techniques. The peoples of the more advanced countries stand to gain by helping to enrich their poorer neighbours: it is entirely wrong to suppose that the economic advancement of the backward countries threatens the industrialized countries with a loss of markets. The exact opposite is the truth: for the limitation of

markets in the past has arisen out of the sheer poverty of most of the world's consumers.

No doubt, industrialization of the backward countries does involve changes in the character of the exports of the more advanced countries. These will tend to lose trade in those goods which can be most easily made with relatively unskilled labour, and are in large demand among the poorer classes of consumers. Such things the less advanced countries will tend in future to make for themselves, or to exchange with other relatively poor countries, instead of importing them from countries with high living standards. But as the total market for the cheaper and more easily produced commodities expands, the market for goods of higher quality and finish will expand with it; and such goods, including the machine equipment of the industries which make cheap goods for mass-consumption, will have for the most part to be brought in from abroad. The more advanced nations which are promptest and most successful in adapting their industries to produce these types of goods for export at prices not inflated by either inefficiency or monopoly will prosper as a result of economic development in the backward countries: those which fail to achieve these adaptations will fall behind.

Moreover, industrialization is only one of the purposes which the investment of capital in the less developed countries is designed to serve—if by 'industrialization' is meant the stimulation of mining or manufacturing industries in these countries. Much more of the borrowed capital can best be spent, not on the establishment of industrial enterprises, but on raising the standards of agricultural production and improving the means of transport and marketing of agricultural produce. To be sure, this involves, if loan charges on the borrowed capital are to be met, the existence of foreign markets open to an increasing volume of agricultural imports; for the more backward countries cannot borrow for the expansion of their agriculture unless they can increase their agricultural exports enough to cover the cost of the loans.* But to the extent to which foreign loans are used to improve agricultural production and marketing, the more advanced countries have the less to fear in respect of the displacement of their exports, and indeed the more to hope, pro-

* Naturally, when under-nourished peasant populations are enabled to increase their output, a large part of the increase goes into higher home consumption, and not into exports. This, however, does not apply to 'cash' crops, especially of agriculturally produced raw materials or of specialized 'foodstuffs', such as coffee and cocoa, or soya beans.

vided that the less advanced countries are allowed to find markets for more of their primary products and thus to increase their power to purchase manufactures, including capital goods, which they cannot produce at home.

It will be of the greatest importance that borrowing as well as lending countries shall share in the control of the international agencies set up for the purposes described in the preceding paragraphs. Foreign investment in the past has been too often conducted on the principle that only lenders have rights. In equity, the borrower has at least an equal right with the lender. It is primarily on the people of the debtor country that the investments made will react for good or ill; and nothing would be more likely to lead to acrimonious disputes between countries than a policy of international investment carried out by and under the control of lenders on the soil of the borrowers and on the bodies of the peoples of the debtor countries. What needs to be emphasized is the necessity of guarding by all possible means against projects supposed to be designed in the interests of the undeveloped countries becoming a new form of 'economic imperialism' based on the interests of great industrial pressure groups.

If these conditions can be satisfied, it is practicable to re-build, and indeed greatly to extend, the system of long-term foreign investment which grew up during the nineteenth century, and to do this greatly to the advantage of the world as a whole. As we saw, one indispensable condition is that the rates of interest shall be low, so as to avoid weighing down the borrowers with debt burdens which will involve, where loans are taken up at all, the exploitation of the peoples of the backward countries for the benefit of the capital-owners of the more advanced. Low interest rates involve the pooling, and therewith the reduction, of investment risks, and the direct participation of the Governments of the lender nations. But private as well as government investment will have to be invoked, in order to secure adequate American participation, which is obviously vital; for American opinion will not stand for a scheme based entirely on public lending. It may be added that amortization rates, where they are used, will have to be low, and that it will probably be necessary to provide for the re-investment of sinking funds in the borrowing countries.

XV

THE KEYNES AND WHITE CURRENCY PLANS

BEFORE the war ended, there were many discussions about the monetary arrangements that would be needed during the period of transition from war conditions to post-war 'normality', and about the shape of things to come in respect both of monetary policy and of international trade and investment. Much of this discussion took place between representatives of the British Treasury and of the United States State Department, with Lord Keynes as the principal British negotiator and Mr. Harry White representing the Americans. Other countries of course came in too—especially France; but the main negotiations took place in the earlier stages between Great Britain and the United States. There were in effect three closely linked issues to be settled—those dealing with currency and credit arrangements, those dealing with problems of long-term investment of capital, and those dealing with international trade policy. Connected with these three main issues were such more special problems as the bringing to an end of Lend-Lease and similar wartime arrangements, the means of settling debts which had accumulated during the war, and—in the background—the question of reparations to be exacted from Germany. Closely connected with the matter of international trade policy was that of employment policy; for it was recognized that national trade policies would be greatly affected by the prospective situation in this respect. To a great extent these various matters were discussed separately; but they were all closely intertwined. In this chapter I am, as far as possible, dealing with only one of them—or rather with two, currency and credit—and with these aspects of the wider problem only at the stages reached before the conclusion of the Bretton Woods Agreement of 1944.

The main issues that arose in the course of this preliminary conversation were, I believe, the following:—

1. If the old 'self-regulating' gold standard had broken down, as it clearly had done in the 1930s, was it possible or desirable either to restore it in a somewhat altered form or to find a substitute which would serve to some extent the same purpose of stability in exchange rates between the currencies of the leading countries?

2. In view of the difficult situation as between 'creditor' and 'debtor' countries which existed before the war, and was certain to re-appear in greatly aggravated form, could means be found of preventing the lack of balance between such countries from paralysing international trade and resulting in a restrictive network of exchange controls, bilateral commercial agreements, and the like, which threatened to reproduce the evils of pre-war 'economic nationalism' on a greatly increased scale?
3. Was it possible to check the practice of accumulating unspent short-term capital in the world's monetary centres, and of shifting this capital ('hot money') from one centre to another with highly disconcerting effects on monetary stability?
4. Was it possible to re-build the system of long-term foreign investment, which had largely collapsed in the 'thirties, in such a way as to convert short-term surpluses into long-term loans, without imposing on the borrowing countries conditions which they would feel to be intolerable or burdens which they could not hope to liquidate?
5. Was it possible or desirable to apply the principles of banking and bank credit, which had been applied internally in every developed country, on an international scale?
6. Should there be a new kind of international money, either to replace or to supplement gold as an instrument for the settlement of international balances?
7. Should some action be taken after the war to start each country off with a supply of internationally spendable purchasing power, additional to such resources in gold or foreign exchange as it might then possess?
8. Should any action be taken to induce or compel countries which exported more than they imported (after allowing for existing long-term capital items) to convert their 'surplus' either into additional imports or into long-term foreign investments, or even to cancel such balances if they remained unspent in either of these ways?
9. Should any action be taken to induce or compel countries which imported more than they exported (again after allowing for existing long-term capital items and also for new long-term imports of capital) to reduce their 'debits'; and could any such action be taken without a deflationary effect on the world economy?

10. Could the treatment of the finance of current economic transactions between countries, apart from capital transactions, be separated from the treatment of the finance of capital transactions, or must the two be handled together in any scheme of post-war monetary regulation?
11. To what extent should any international agreement on monetary questions be linked with, or made contingent upon, parallel agreement about international policies in the fields of foreign trade and employment, such as agreements to abandon or modify imperial preferences, quota schemes, and bilateral trading agreements, or with agreements by Governments to pursue internal and international policies designed to maintain full employment?
12. Should any proposed international monetary authorities or unions, including international investment agencies, be open equally to all countries, including (*a*) small or backward countries, (*b*) enemy countries; and to what extent, if at all, should narrower monetary unions or agreements, such as the 'sterling area', between particular States be ruled out or restricted?

These twelve questions do not cover the whole of the ground that was under debate before the Bretton Woods Agreements were drawn up; but they serve to bring out most of the important points. Their range is wide, as it was bound to be; and one thing is so tied up with another that it is difficult to discuss them separately. The history of the long Anglo-American negotiations began, as far as the public is concerned, with the publication in 1943 of two monetary 'Plans'—the 'Keynes Plan' issued by the British Treasury and the parallel 'White Plan' issued in the United States. These were both attempts to deal with the more specifically monetary problems without more than incidental reference either to the problems of international long-term investment or to those of international commercial policy. This attempt to isolate the purely monetary problems gave rise to difficulties; but it seems best to begin by outlining and commenting upon these two Plans, as they provided the first clear indication of what was in the minds of the responsible financial advisers of the British and American Governments, and also because they included certain interesting proposals that were subsequently dropped.

Both the Keynes and the White Plans were issued to the accom-

paniment of disclaimers that the Governments responsible for giving them to the public were in any way committed to them. They did, however, evidently represent hopes, if not intentions; and in their differences and similarities they could be taken as indicating the lines which, in the view of the experts on both sides, discussion between the two Governments should have followed. There was at this stage no consultation with the Soviet Union or with any other Government or body of experts. Yet the issues at stake were of supreme importance to the world as a whole.

The Keynes and White Plans both proposed the establishment of a new kind of international money of account, called *Bancor* in the former and *Unitas* in the latter. This international money was, in both Plans, to represent a certain weight in gold and was, under certain conditions, to be exchangeable for gold. In the White Plan the gold equivalent of *Unitas* was specifically fixed: it was to be '137½ grains of fine gold (equivalent to 10 dollars of the United States)'. In the Keynes Plan the gold value to be given to *Bancor* was not stated, and it was said explicitly that this value need not be fixed once and for all.

Neither *Bancor* nor *Unitas* was meant to be money in the sense in which ordinary people commonly use the word. No private citizen was meant ever to possess any, even in a bank account—much less to use a *Bancor* or *Unitas* note to settle a debt. *Bancor* and *Unitas* alike were meant to be 'monies of account', to be owned and used exclusively by Governments or Central Banks for the settlement of international debts—and not of all international debts, but only of those which remained to be settled after the existing means had been used. They were essentially intended as means of settling such international balances as had in the past been settled either by moving or earmarking gold or by the holding of funds in one country on behalf of another. The clients of the proposed International Clearing Union, or 'United Nations Stabilization Fund'—the American name for the new institution proposed—were to be Governments or Central Banks, not private persons or companies: except that the Keynes Plan also contemplated that the Clearing Union should act for such international agencies as might be set up for Relief and Rehabilitation, or for the development of projects of international investment.

The proposed new 'money of account' was to provide the standard to which the various national currencies were to be related. Under the White Plan, not only *Unitas* but also each national

currency was to represent at any moment a fixed weight of gold, and was therefore to have a fixed value in *Unitas* as well as in gold. This amounted to a proposal to return to the gold standard in its most essential feature—that of a fixed gold value for each currency, and therewith a practically fixed ratio between the values of the different currencies. Indeed, it appears as if, in the original form of the Plan, relative currency values would have been fixed even more rigidly than under the old gold standard, as presumably balances would normally have been settled by transfers in the books of the new international institution, rather than by transferring gold, so that the movement of exchange rates between the 'gold points' would have tended to disappear. The Keynes Plan also contemplated the establishment of a value for each national currency in terms of *Bancor*; but it proposed to leave room for the alteration of these values in order to correct valuations which ceased to correspond to internal conditions in the countries concerned. It was clearly contemplated that from time to time the *Bancor* values of the national currencies might need to be changed. Keynes aimed in effect rather at short-term stability of exchange rates, and at preventing changes except for good cause, than at permanent stabilization under a new international gold standard.

The Keynes Plan proposed to leave each State, in agreement with the others, to fix the initial value of its own currency in terms of *Bancor*. When the *Bancor* values of the various countries had once been fixed, they would have been alterable only under certain conditions. A State which had been for two years in substantial deficit on its balance of payments would have been entitled to decrease the *Bancor* value of its currency by not more than 5 per cent.; but this could have been done only once, and all other changes would have needed the consent of the Clearing Union. The Union Board was to be empowered to agree to any change in the *Bancor* value of a currency asked for by the State of issue, and was to have a limited power to require a reduction from a country in serious and persistent deficit. The Keynes Plan contemplated an initial period during which national currencies would gradually settle down to stable relative values, and thereafter a system under which these values would be altered only rarely, and on special grounds.

This went a long way towards reinstating the gold standard; but it did at least leave the door open to internationally agreed alterations in exchange rates for the purpose of meeting a situation which could otherwise be met only by drastic internal deflation. The

White Plan, on the other hand, banged the door. It obliged each State which joined the Stabilization Fund 'to maintain by appropriate action the exchange rates established by the Fund on the currencies of other countries'. What this meant was nowhere explicitly stated; but what could it mean except that the country in question was to resort to deflation in the old-fashioned, gold standard way if its currency got into difficulties? This was a great deal to ask any country to pledge itself to, in the knowledge that it would mean, whenever the United States had a slump, spreading that slump far and wide through other countries, and forbidding those countries to resort to the monetary expedients which would be indispensable if they meant to take measures for maintaining full employment. The White Plan, in effect, proposed to put back the gold standard in all its rigidity, to reimpose it by embodying it in a binding international agreement, and to compel countries to return to the old, discredited methods of deflation as the means of correcting an unbalanced exchange position.

It is, of course, easy to understand why the Americans, in the scheme which they put forward, should have had at heart the maintenance of the value and of the sanctity of gold.

Even the Keynes Plan, though infinitely superior to the White Plan in this respect, went much too far towards putting gold back on its pedestal. It may be desirable, as part of an agreed plan of international monetary regulation, to have some safeguard against unilateral action by a country to decrease the exchange value of its currency for the purpose of expanding its exports to the detriment of others. Countries can reasonably be required not, save under the pressure of sheer necessity, to alter the exchange value of their currencies without prior notice and consultation. But beyond this they can fairly claim to be left free in the last resort to settle the value of their own money, as a necessary condition of their freedom to follow policies of full employment. Provisions about notice and prior consultation can reasonably be insisted on—though prior notice raises some awkward problems in the control of currency speculation; but it ought surely to be left to each country (or group of countries, where several act together in such matters) to determine in the last resort what the gold or international value of its own money is to be.

When I say that countries should have freedom, in the last resort, to regulate their currencies without being subject to international control, I do not at all mean to rule out arrangements between

countries to follow common monetary policies or to make their currencies freely exchangeable. On the contrary, such arrangements are highly desirable wherever the underlying conditions allow them to be made without sacrificing any country's well-being either to the dictation of a stronger country or to the shibboleth of the gold standard. The sterling area is a good thing, because it liberalizes trade among a number of countries which would all be worse off if they attempted to manage their several currencies without mutual accommodation. So is the European Payments Union a good thing, for the same reason. Neither of these institutions works perfectly, or without friction. Australia has misbehaved by overdrawing on the sterling area's dollar pool; and in the E.P.U. France, as a persistent debtor, has used its drawing rights to postpone the need for bringing its prices into a realistic relation to the nominal gold value of the franc. But these abuses, like the use made by Great Britain of dollars belonging to the Colonies, are incidental: nothing that is said in this book is meant to imply that monetary, any more than economic, nationalism is anything except bad.

What I am insisting is that the benefits of monetary internationalism, like those of non-discriminative trading, are limited to cases, and to areas, in which a fundamental equilibrium either exists or can be brought into being. The sterling area is good because it is workable: it helps to free transactions over a large part of the world because these transactions can be set free without giving rise to crises between surplus and deficit countries within the area—that is, because there is no chronically 'scarce' currency within it. E.P.U. works rather less well, mainly because of the instability of France; but all the same it is much better than nothing. Such arrangements are on a quite different footing from universal monetary agreements which tie together, on terms of free convertibility, countries between which fundamental economic disequilibria exist; for monetary union is powerless to remove these, and, where they exist, the unavoidable outcome of free convertibility at fixed exchange rates is crisis, followed by a stampede to national restrictionism in its most destructive forms.

The 'gold standard' aspects of the Keynes and White Plans have been considered first because they gave rise to the most fundamental objections. It would be better to have no international system at all than one which would involve a return to the old days of enforced deflation. But, of course, neither the Keynes nor the White Plan was deflationary *in intention*—quite the reverse. Both Plans were

meant to provide a basis for the post-war expansion of international trade, and to deal with a situation in which, in the absence of special measures, a good many countries were bound to find themselves almost entirely devoid of the means of purchasing abroad even the most indispensable supplies. In both Plans the most important positive feature was a device for placing at the disposal of *all* signatory countries an initial supply of international purchasing power to tide them over the difficulties of the post-war period. In both Plans it was proposed to achieve this by allowing each country what amounted to an overdraft facility up to a fixed maximum in the books of a new international banking institution. Just as banks within each country create credit, this institution was to create a new supply of international purchasing power; and each country was to be given a quota on which it could draw to meet its need for foreign exchange. All the countries which agreed to take part in the Plan—either Plan—were to agree to accept this new international money as the equivalent of gold at the value fixed for it; and a transfer of credit in the books of the new international institution was to be accepted as a settlement of debts between countries or Central Banks.

The American Plan was indeed much more hesitant than the British in recognizing overtly that what it proposed was in effect a new creation of international money, analogous to credit creation within a single country. The White Plan proposed that the Stabilization Fund should be started off with compulsory subscriptions, payable partly in gold and partly in national currency and securities, from the member States: so that the new money appeared to represent these deposits and not to be newly created. To the extent to which the White Plan required deposits to be made in gold, and so reduced the credits which countries could themselves create by the amount of these gold deposits, there would have been no new creation of money. But for the rest the White Plan, despite its conservative phraseology, did in effect postulate a new creation of international money not different in principle from what was openly advocated in the Keynes Plan.

This notion of a new creation of international money was entirely sound. Why should the world not have an 'International Bank', entitled to create credit for international, as Central Banks have hitherto authorized its creation for national, purposes? Of course, any such creation of credit would add to the world supply of means of payment. It would be 'inflationary', if without it the world

would have had enough effective purchasing power to finance full employment in all countries and a high level of trade between them. But plainly the world was not in this position, or likely to be unless special measures were taken to bring it about. Even if the total stock of gold was big enough to serve this purpose, it could not have done what was needed, for most of the gold belonged to the United States, and was not available for financing the world's production and trade. If the United States had been prepared to *give away* its gold, sharing it out among all nations in proportion to their needs, it might have been unnecessary to resort to a new creation of purchasing power for giving post-war trade a flying start. But clearly the United States had no notion of behaving in this way; and a mere willingness to *lend* gold to other countries would have been of no use for the purpose in view, because, being already in debt, or threatened with being in debt, to the United States, they could not have afforded to borrow it. Accordingly, it was clear that, if the countries impoverished by the war were to be put in a position to buy one another's goods at fair prices, they would have to be started off with credits on a large scale—above all, those countries which had been seriously devastated and would have to live partly on credit until they had been allowed time to restore their productive capacity.

The proposal to create a new kind of international purchasing power, based essentially on the world's capacity to produce under conditions of full employment, was therefore good sense. But as soon as we look at the methods proposed in the two Plans for achieving this we see how big the differences were. The Keynes Plan proposed to base the credit quotas which were to be made available to each country on the pre-war value of each country's foreign trade (imports *plus* exports). The quotas proposed at the start were 75 per cent. of the average value of each country's foreign trade over the three years before the war, with subsequent revisions in accordance with the actual post-war trade of the countries concerned. This formula would have yielded a total of initial quotas roughly two-thirds the size of total pre-war gold reserves, but of course very much more evenly distributed. The White Plan did not state the formula according to which quotas were to be allocated; but the total fund for which it provided was on a very small scale, and the effective amount of credit available under it was further reduced by a number of complicated provisions both limiting the amount that could be made use of by any single country and

requiring large deposits of gold by all the countries which entered into the scheme. Apart from sheer conservatism, the only conceivable purpose of these gold deposits, which would in themselves have had a deflationary effect where they were drawn from the reserves of countries likely to need credits, seemed to be to help the United States to lend a part of its surplus gold to countries which could not afford to buy it.

The granting of credit quotas to all countries was the one really valuable feature of both Plans. It would enable world trade to get re-started. It is, however, important to realize that the quota was designed only as an initial credit. The assumption underlying both Plans was that, given a few years for setting their post-war houses in order, countries would be able to return to a condition of 'equilibrium' in which what they had to pay abroad would balance what they received from abroad, so that each country's account in the books of the International Clearing Union or Stabilization Fund would tend to balance.

Where there is no international agency, and each country acts as a separate financial unit, balance, in a sense, must always exist. International payments are made up of three separate streams: payments arising out of current transactions, payments arising out of long-term capital transactions, and short-term capital payments. The first include, besides the finance of current trade, transport and insurance, payments of interest and dividends on existing investments; the second are made up of payments in respect of *new* long-term investments; the third include gold movements, short loans made from one monetary centre to another, and sums due but not withdrawn from, or placed in long-term investment in, the country in which the funds are left. The sum of all these transactions into and out of a country must always balance; for every exchange of one currency for another implies a two-way transaction. But balance in the aggregate does not imply balance in the separate elements. Apart from gifts, a country which imports more than it can pay for with exports *plus* returns on shipping and insurance services and on overseas investments may be meeting the difference by exporting gold or, alternatively, either out of imports of long-term capital * (e.g. where foreigners are buying up shares in its industries or it is selling off its own past foreign investments) or out of imports of short-term capital, which may mean only that sums due from it to

* Including, of course, public capital when a Government lends money to another Government.

other countries are not being withdrawn from, or that foreigners are depositing short-term funds in, its money market.

If an International Clearing Union, or some similar body, exists, the position is somewhat altered; for there is then the additional possibility of meeting a current deficit by drawing on any credit available in the books of the Union. The country which does this puts itself in debit to the Union instead of owing the sum in question to particular countries or to the citizens of particular countries. Consequently, its payments will balance in total only if its debt to the Clearing Union is taken into account.

This point becomes important when we consider the proposals made for dealing with countries which remained persistently in debt to the Clearing Union. If a country went on drawing on its credit balance with the Union in order to meet its foreign commitments, it would eventually exhaust its quota, and be unable to draw out any more. Indeed, long before its quota was exhausted, both Plans proposed that corrective measures should be brought into play. Under the Keynes Plan, no State would have been allowed to increase its debit balance by more than a quarter of its quota within any one year without the permission of the Governing Board. If over two years its average debit balance exceeded a quarter of its quota, it was to be allowed to devalue its currency, but by no more than 5 per cent. If its debit balance reached half its quota it might be required to deposit collateral security. It could not exceed half its quota without complying with certain requirements of the Governing Board, which might include further devaluation, control of capital movements, surrender of part of its own reserves of gold and foreign exchange—all at the discretion of the Board, which could in addition 'recommend to the Government of the member State any internal measures affecting its domestic economy which may appear to be appropriate to restore the equilibrium of its international balance'. If a country's debit balance exceeded three-quarters of its quota over the average of a year, the Governing Board was to be entitled to take further measures, and could, if it saw fit, refuse the country any further credit.

Clearly, even under the Keynes Plan, the proposed credit facilities were hedged round with plenty of conditions, the plain purpose of which was to make countries regard their credit quotas, not as sums on which they could go on drawing freely until they were used up, but rather as advances granted in order to allow reasonable time for each country to get itself back into a satisfactory state of balance.

A satisfactory state of balance must be regarded as one in which a country can meet its external obligations out of the sums accruing to it from its exports, including 'invisible exports', *plus* any net amount which foreigners are investing in it at *long-term*, but *not* including *short-term* foreign lending as defined above. If all transactions across national frontiers passed through the books of a Clearing Union, the Union would have knowledge of all the relevant factors, and would be in a position to say how far a debit in its books indicated a real deficit on the part of the country concerned. But this was not proposed. Neither the Clearing Union put forward in the Keynes Plan nor the Stabilization Fund in the White Plan was to handle all international financial transactions. Neither was meant to deal with long-term capital movements, or to have any monopoly of dealing with short-term transactions. Accordingly, a debit balance in the Union's books might have arisen, not from a country buying more than it could really afford to pay for, but from the use of part of the sum that could have gone to pay its current debts for quite other purposes, such as a 'flight of capital' from it, either by way of long-term investment abroad, or through the movement of short-term funds to evade a threat of devaluation, or for any other reason.

It would be indispensable for any International Clearing Union or similar body, in order to exercise intelligently such control as was placed in its hands, to have knowledge of what was happening over the whole field of international financial transactions, and not merely of those which passed through its hands. And it would be indispensable, if countries were to avoid having their deficits on current account aggravated by 'flights of capital', for capital movements to be controlled. We have seen already that control of outward capital movements was one of the measures proposed in the Keynes Plan for dealing with countries which fell seriously into debit in the international clearing account; but it was not made clear whether this control was to cover movements of short-term as well as of long-term funds. This would have been necessary in order to make it effective; and there seem to be very good reasons for establishing such controls, not merely as exceptional measures designed to deal with debits when they have been incurred, but as a normal part of each country's mechanism of international financial regulation.

Under the Keynes Plan, the proposed Clearing Union was to be administered by a Governing Board of from 12 to 15 members, the States with the larger quotas having each one representative and the

other States being grouped for purposes of representation. Voting was to be by quotas and not by counting of heads; and each State, whether represented on the Board or not, was to be entitled to maintain an agent who would attend the Board when his country's affairs were under discussion. The White Plan was less explicit; but it proposed to vest power in a Board of Directors, on which each country was to be directly represented, voting to be based roughly on quotas, subject to the provision that no one country should have more than one-quarter of the total votes. This would have meant a large Board, and the White Plan proposed the election from it of an executive committee, with which in practice a great deal of the power would have resided. The provisions of the White Plan were so drawn that in effect the United States would have held an effective veto on any substantial modification of its very rigid conditions.

Both Plans were designed to check the accumulation of short-term balances in the world's leading monetary centres, by causing a part of such balances to be transferred into credit balances held in *Bancor* or *Unitas* in the books of the international agency. But the accumulation of short-term balances abroad would not have been prevented altogether, as it was not proposed that the new agency should have any monopoly of international financial transactions. It would therefore have been necessary for the individual countries to establish their own machinery for the control of short-term capital movements.

To a considerable extent, it is evident that current and capital transactions must be handled together; and both the British and the American proposals were admittedly incomplete until they had been supplemented by parallel proposals for dealing with capital movements, both long and short. A purely financial agreement which tied countries not to pursue bilateral commercial policies would have been certain to break down unless it had been accompanied by a parallel agreement or agreements dealing satisfactorily with the main issues arising in the field of international commerce and with employment policies.

What was missing in both plans was any discussion on what was to be done if countries exhausted their credit facilities and an unbalanced international economic situation were found still to exist. There was no hint in either of the need, which was soon found to exist after 1945, for huge *gifts* from the United States to other countries in order to prevent collapse.

XVI

INTERNATIONAL INVESTMENT AND THE STANDARD OF LIVING

THE two plans discussed in Chapter XV dealt only with problems of short-term international finance. Their publication, however, was soon followed by the appearance of a further American Plan—unaccompanied, this time, by any rival British draft. In this second White Plan it was proposed to establish an international investment bank with a capital rising from an initial 2,000 million dollars to an ultimate total of 10,000 millions. This sum was to be subscribed by the member countries, lenders and borrowers together. Clearly, in practice, most of it would have had to come in the first instance from the United States, which alone could have any considerable surplus available for international investment. The national quotas were to be subscribed partly in gold and partly in the currencies of the member countries, the proportion to be paid in gold being limited to one-fifth as a maximum, with smaller proportions for countries short of gold. But in addition each country was to be under an obligation to redeem in gold its subscription of its own currency at a rate of 2 per cent. per annum—so that it was apparently contemplated that in the end the whole of the 10,000 million dollars would be converted into gold. Nothing was said about *Unitas* or *Bancor* in this connection as a substitute for gold: there was no attempt to link up the proposed International Bank with the Stabilization Fund contemplated in the earlier White Plan.

In addition to the capital subscribed by the Governments of the member countries, the Bank was to be empowered to raise further capital by borrowing in the private investment markets of the world. There was, accordingly, no limit to the amount of capital that could be provided for international investment under the scheme.

There were, however, very substantial limitations on the purposes to which this potentially vast capital fund could be applied. The memorandum explaining it reiterated that the proposed Bank was in no wise meant to supersede or rival private international investment, and that it was to be used only for schemes which lay outside the field of private enterprise or were beyond the scope of private investment because of the vast scale on which they needed to be launched. It was also stressed that the new Bank would deal only

with Governments or with government agencies. It was not to make loans to private bodies unless they were guaranteed by the Governments of the countries concerned; and in general it was to guarantee private loans made to Governments or government agencies in preference to making such loans itself. All these provisions were evidently intended to disarm critics who might be disposed to attack the proposal as an encroachment on the field of private enterprise.

Once again, in this Bank Plan, there appeared the American desire to find means of restoring the gold standard and of reinforcing it by international sanctions. Hence the provision for the subscription in gold at first of a part and ultimately of the whole of the Bank's proposed capital of 10,000 million dollars. Gold, however, was not what the nations which were to receive the capital wanted most urgently: they wanted goods. If they could use the gold, or rather the credit based upon it, to get goods, well and good. But how was this to come about? The United States is a surplus country on current account: it has a surplus of exports for which the recipients cannot afford to pay. International balance can be restored, unless the United States is deliberately to reduce its exports, only if these exports are themselves converted in part into long-term loans. But the United States, if it thus subscribed capital in the form of goods, could not subscribe it in gold as well, without a further swelling of the total amount of the debt owed by the borrowing countries. It was of the greatest importance to keep the debt burdens of the borrowing countries down to the minimum that was really needed for the effective development of their resources. To add to their burdens by making them buy gold which they could not afford was surely the height of folly.

These are criticisms of the form of the second American plan, rather than of its underlying intention. It was highly desirable that there should be a large plan for international long-term investment for the purpose of developing the resources of the backward countries; and it was obviously on the United States that a large part of the financing of such a plan was bound to fall. Clearly, if the United States were to supply in goods the capital instruments needed by the borrowing countries, the effect would be to swell correspondingly the total of American exports, and the existing surplus of exports over imports would remain untouched. The only way of reducing this surplus was for the Americans to get paid for their surplus of current exports, apart from any new ones arising from the plan, in

the form of shares or bonds in foreign undertakings or government debts, the money thus made available being spent *not* on American goods but on capital goods made in countries which had an adverse balance to meet in the United States. In others words, British and other European goods would need to be sent to the borrowing countries in payment of debts owing to the United States; and the ownership of the capital assets thus created would need to accrue to the United States Government or to private American investors. This was the only way, except by outright gifts, in which the American current surplus could be applied to meeting the capital needs of the deficit countries.

Of course, this did not mean that *no* American capital goods could be sent to the borrowing countries. Clearly, such a condition would have been out of the question. But such American overseas investments as took the form of exports of *American-made* capital goods (or indeed consumers' goods), unless they were given away, could do nothing to reduce the size of the American surplus. Accordingly, the Americans needed, if the plan was to work, to lend abroad much more capital than they sent out either in additional goods or in gold. They would have to acquire ownership of capital resources either produced in the borrowing countries or imported from countries which owed money for current purchases from the United States.

Clear statement of this evident truth was often deliberately avoided on the ground that the notion of financing large schemes of international investment was likely to make a much greater appeal in the United States if the American people saw themselves as the prospective suppliers of the capital goods which would be needed than if they realized that most of these goods would have to be produced elsewhere. There was, however, no escape from this necessity. A country cannot go on exporting more than it is prepared to import unless it is prepared either to give the surplus away or to accept foreign capital assets in payment. If the inconveniences of accumulating vast short-term assets abroad are recognized as intolerable, there remains open only the acquisition of foreign long-term capital holdings constructed by the labour and capital resources of the debtor countries.

The proposal to form an International Bank for long-term investment had evidently to be considered in relation not only to the proposed Clearing Union or Stabilization Fund but also to the proposals for short-term relief and rehabilitation under the auspices

of the temporarily constituted United Nations Relief and Rehabilitation Administration (UNRRA). UNRRA was given a constitution under which it was administered by a Central Committee representing the four Great Powers—the United States, Great Britain, the Soviet Union, and China—subject to the approval of a general council or assembly representing all the participating countries. It was to work mainly through sub-committees, some dealing with the organization of supplies and representing the supplying countries, and others on a regional basis, to take charge of the distribution of the relief and aid in recovery in the principal regions needing immediate help—Europe, the Middle East, the Far East, and perhaps others.

Finally, it is necessary, in painting the picture of projects of post-war financial and economic re-organization, to take account of the plans for a world nutrition policy outlined at the Hot Springs Conference of 1943 (out of which arose the present Food and Agriculture Organization) and of the accompanying proposals for special measures to stabilize, through commodity agreements, the prices and conditions of supply of a number of the principal foodstuffs needed for implementing a programme of improved nutrition throughout the world. To the extent to which the countries engaged mainly in primary production of foodstuffs and raw materials could get, as a result of these and other agreements, better prices for their commodities in terms of manufactured goods and also an enlarged market capable of absorbing all they could produce, their balance of payments problems would be eased and their power to contribute native capital towards their own internal economic development would be enlarged. They would need less by way of foreign gifts or loans, and be able to carry out larger projects of development with any given amount of help from abroad. Thus, projects of improved nutrition and better agricultural prices worked in with the rest of the plans for international action—but only on the assumption that these projects did in fact lead to an expanded market and not to a restrictive rise in prices based on a reduction of supplies. At the outset, a world policy of improved nutrition for all the peoples was bound to impose burdens on the more advanced countries; for the worst-fed peoples could be fed better only if the better-fed peoples consented to eat less until there had been time to raise the standards of productivity in the more backward areas. This 'eating less' meant that the richer countries would have deliberately to refrain from using their superior purchasing

power to divert foodstuffs from the more needy countries to themselves.

Here a difficulty arose. The more successful measures for raising the prices of foodstuffs were, the more, at the outset, would they tend to divert supplies from the needier to the wealthier countries. It was therefore necessary for the latter, until the world shortage had been overcome, not merely to refrain from eating more, but to pay for supplies for distribution to the needy countries in accordance with the requirements of the policy of improved world nutrition. To some extent, this need was covered up to the end of 1946 by the activities of UNRRA in the field of post-war relief, and also by the special measures belatedly taken to cope with world famine in 1946. But the famine of 1946 served to show that the problem of nutritional standards extended far beyond the field which UNRRA was intended to cover, and that a better nutrition policy for the world as a whole would demand far larger capital appropriations, as well as far greater sacrifices on the part of the richer countries, than appeared to be in contemplation when the United Nations Food and Agricultural Organization was set up in 1945.

These considerations may seem to have taken us a long way from the subject of money, but they could not be left out, because they were absolutely bound up with the problems of international investment and the balance of payments between countries. Backward countries could not begin to improve their standards of nutrition unless they could either produce more food at home, or import more food from abroad, or export less food in payment for imports, or all three together. They could not easily raise their standards of production without help from foreign capital; they could not import more unless they could find means of paying for it, or could be given it, or be lent the means of payment in the form of capital investment in their productive assets; and they could not afford to export less and consume more at home unless they could be given or lent the means of paying for imports which they had hitherto paid for with exported food. If the relative prices of their food exports improved, this would ease their difficulties to some extent, but would not do away with them. Moreover, if their purchasing power were increased, they (or rather the members of their communities who enjoyed the additional purchasing power) might prefer to spend a good deal of it, not in raising nutritional standards among the general body of the people, but in buying more luxury goods from abroad. The effects on demand of a rise in national

purchasing power depend on the distribution of this purchasing power among different sections of the people. Where power and wealth in the needy countries reside in a feudal or commercial governing class rather than in the main body of the people, there may be little or no improvement in standards of nutrition even when the total national income has been substantially increased. A world policy of better nutrition could succeed only if the balance of power in the poorer countries were shifted decisively in favour of the common people.

Would the kind of international agency the Americans proposed for the supervision of the process of investment in the backward countries actually work in such a way as to favour these needs? There was evidently serious danger that it might not. Created mainly as an agency for stimulating and guaranteeing private investment rather than for making investments of its own, the proposed International Bank would be in danger, even if it succeeded in this, of fostering those forms of investment which appealed most to capitalist interests in the lending and to feudal elements in the borrowing countries, and of becoming an instrument for exploiting the cheap labour of the latter rather than for raising their standards of life. Of course, this need not have been the case if in the borrowing countries there could be resolute democratic Governments determined to prevent it, or if the lending countries acted resolutely in the spirit of world democracy even against the pressure of their own capitalists. But these were large 'ifs'.

In effect, a great deal was bound to turn on the character and extent of the international investment undertaken directly by the new agency itself, and not by private investors stimulated by its guarantees. We have seen that, under the American Plan, such direct investment was to be confined to projects which were either outside the scope of private investment or prohibitive to private investment on account of their cost. This seemed to envisage that the projects to be sponsored directly by the Bank would be major schemes analogous in character and range to the establishment of the Tennessee Valley Authority in the United States—i.e. huge schemes serving wide areas through the development of electric power and irrigation or land drainage, or big projects for the improvement of land or water transport. There had been talk, most of it rather vague, of a 'Danube Valley Authority' or of similar schemes involving unified development in the territories of several neighbouring States; and clearly, the more such plans, even if they

had to be on a rather less extensive scale than some of the projectors suggested, could be developed across national frontiers, the more hope there would be both of breaking down autarkic tendencies in the national States which the Governments of the United Nations had pledged themselves by the Atlantic Charter to restore, and of avoiding the imperialistic domination of the smaller countries by their larger neighbours in such a way as to reduce them to economic satellites of the great Powers with which they had the closest political connections.

If projects of this order and magnitude, operated through international functional agencies established *ad hoc* for each major scheme, could have been given a large place in the work of the proposed International Bank, there seemed to be hope that they would not be subject to the dangers of economic-imperialist exploitation which were likely to beset ventures sponsored by private investment agencies. When, however, one called to mind the intense hostility displayed by a large section of American business towards the Tennessee Valley Authority, it was not easy to feel confident that the Bank would be given freedom to develop its work along similar lines without being accused of invading the legitimate field of private enterprise. Nor could it be left out of account that international schemes of capital development would be bound to run into difficulties wherever they involved crossing the doubtful frontier line between the Soviet and Western 'spheres of influence', or action in areas disputed between the two. Only an agreement for common world action between all the United Nations could have removed these obstacles; and after 1945 the hopes of such action rapidly faded away.

XVII

BRETTON WOODS

Out of the Keynes and White Monetary Plans emerged, first, a joint Plan, agreed upon by the British and American experts, and subsequently the definitive United Nations Monetary Agreement drawn up at the Bretton Woods Conference of July 1944. The Bretton Woods Conference was attended by representatives of 44 countries, including the Soviet Union and France, as well as the United States and Great Britain. It adopted two Plans—one for an International Monetary Fund and the other for an International Bank for Reconstruction and Development—dealing respectively with monetary measures and with long-term international investment. In form, both these agreements were based mainly on the White Plans originally put forward by the American State Department; and the Monetary Fund was much nearer in spirit to the White Plan of 1943 than to the Keynes Plan. It will be most convenient to consider separately these two halves of the Bretton Woods structure, and to begin with the monetary part of the scheme.

The critics of the Bretton Woods Monetary Agreement have throughout insisted that it involves in substance a return to the gold standard, whereas its defenders at any rate began by denying this. It was not disputed that gold was intended to serve under the Plan as the measuring rod for settling the values of the various national currencies, and therewith their relative values in international exchange. But the defenders of the Agreement insisted that under it the gold values of the national currencies were to be fixed not unalterably, as they were supposed to be under the old gold standard, but only in the sense that each national currency unit was at any moment to represent and to be exchangeable for a definite amount of gold, with the proviso that this gold equivalent could be varied by agreement from time to time, either by simultaneous action in all countries, or in most, to alter the gold values without altering the rates of exchange, or by action in respect of a single currency, so as to alter its rate of exchange with other currencies. Simultaneous action to alter the gold equivalent of all, or of most, currencies could obviously be taken only by agreement extending to a large number of countries; and its effect would be to alter the

value of gold in terms of commodities and, by doing so, to influence the rate of gold production by making gold-mining less (or conceivably more) profitable, and so driving 'marginal' mines out of activity (or bringing additional mines into activity). It would, of course, be much more likely to be used in practice, if it were to be used at all, to lower than to increase the output of gold, which as we have seen had been at a very high level before 1939. The quantity of gold produced depends, like that of other commodities, on profitability, which in turn depends on the relation between costs of production and selling prices. Gold production had been high because the United States had been prepared to accept unlimited quantities of it at a price in dollars which made gold-mining highly profitable. This readiness to receive gold far beyond any quantity that could possibly be needed in the United States was maintained partly because, in face of the American tariff, there was nothing except gold in which the United States could receive payment for that part of its surplus on the current balance of payments which its citizens had not been prepared to convert into foreign investments, and partly because if the American buying price for gold were reduced there would be an immense paper loss on the vast gold stock already in the United States.

The rise in commodity prices during and after the war fundamentally altered this situation. The gold content of the dollar remained unchanged; and the value of gold in terms of goods therefore fell sharply. Gold production accordingly declined; and there was a demand from gold-mining interests that the dollar price of gold should be increased. But the Americans, having more gold than they needed, had no inducement to pay more for additional supplies. Other countries, which did devalue their currencies, did of course pay more for such gold as they acquired; but they were not in a position to buy much of it, and the dollar price was the determining factor. It therefore seemed unlikely that the provision in the Bretton Woods Plan for a general simultaneous change in the gold value of currencies would be used to increase the price. As for a decrease, that too was unlikely, under conditions which put the dollar at a premium in relation to other currencies; for other countries could effectively devalue their own money only by reducing its gold value *relatively to the dollar*.

It was laid down in the Bretton Woods Agreement that, even if a simultaneous re-valuation of currencies in terms of gold were made by international agreement, no country could be forced to

re-value its own currency against its will. Simultaneous re-valuation might thus bring about a change in the relative values of some currencies. But the evident intention was that, as far as possible, the main currencies should all move together, so as to leave their rates of exchange unaffected.

This entire provision therefore stands apart from the main sections of the Bretton Woods Agreement on the question of currency values. What the critics hostile to the gold standard objected to principally was the smallness of the scope left for altering *relative* currency values, in order to adjust exchange rates to changes in the national economic circumstances of particular countries, and in particular to leave each country free to adopt such monetary measures as might be necessary for the maintenance of full employment and for the prevention of a contagious spread of crisis and unemployment from one country to another.

On this point the Bretton Woods Agreement, unlike the White Plan on which it was based, did allow some elasticity. Countries entering the International Monetary Fund were allowed in the first instance to fix any gold equivalents they pleased for their national currencies. At least, this applied to original participants, though its application to later entrants was not so clear, because they might in practice be refused admission unless they agreed to fix their currencies at values of which those in control of the Fund approved. When the initial values had been fixed, there was still some scope left for variation; for any country was to be allowed to alter the gold value of its money by one or more stages, up to a total variation of 10 per cent. This it could do unilaterally; but beyond this point it was not to go without the consent of those who controlled the Fund—that is, unless it withdrew from the Fund after liquidating all obligations to it, which might be exceedingly difficult to do. With the consent of those in control of the Fund, further variations up to a second 10 per cent. deviation from the value initially fixed were to be permitted; and the directors of the Fund had either to accept or to reject any proposal falling within these limits within 72 hours if the country wishing to make the change asked them so to do. Further variations, without limit, were allowable with the consent of those who controlled the Fund, subject to a longer, but undefined, period of notice. It was laid down as an overriding condition that 'a member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium'; and it was also enacted that the Fund should not veto any proposed change

'if it is satisfied that the change is necessary to correct a fundamental disequilibrium', and, in particular, that the Fund 'shall not object to a proposed change because of the domestic, social or political policies of the member proposing the change'.

Did these provisions amount in effect to a restoration of the gold standard? What clearly was contemplated was that, after a preliminary period during which countries were to have the right within rather narrow limits to readjust the gold values of their currencies by unilateral action, the world would settle down to a system of linked currencies, all related to gold, and all having defined gold values variable only by mutual consent. This is not the gold standard in its old form; and it is less rigid in the sense that it does contemplate changes in the gold parities of national currencies as being necessary under certain conditions. But, as against this, it is more rigid than the old gold standard, in the sense that under the old system there was nothing to prevent any country from altering the gold value of its currency when it pleased—as the United States did in 1933—without asking any other country's consent, whereas under the Bretton Woods scheme all such changes beyond the initially allowed variations were to require international sanction from a body which would be—to say the least of it—subject in a very high degree to American influence. It can be regarded as an advance to have secured some recognition of the need for flexibility of currency values in face of serious exchange disequilibria; but this gain was secured only at the cost of taking the control of currency adjustment out of the hands of single countries, or of groups working common currency systems, and of transferring this control to the directors of the International Monetary Fund.

In practice, ever since 1945, the conditions of economic disequilibrium have been such that, but for an outpouring of American aid, which was not at all contemplated when the Bretton Woods Plan was drawn up, most of the signatory countries would have been entitled at almost any time to ask for the consent of the I.M.F. to devalue their currencies heavily without the directors having any right to object. Despite this aid, no objections were in fact taken to the British devaluation of 1949, or to the ensuing devaluations of other currencies. The purpose of the Bretton Woods Plan to restore fixed gold values has not been achieved—and cannot be, with any assurance, as long as the fundamental economic disequilibrium remains.

What the critics of Bretton Woods meant when they insisted

that the agreements there made involved a return to the gold standard was that, by the terms on which the International Monetary Fund is set up, each country surrenders its freedom to use currency management, without the consent of the others, as an instrument of full employment policy. The situation which they feared has not arisen, because the fundamental disequilibrium has remained in being, and because the gulf has been temporarily bridged by American aid. The plain intention of the Bretton Woods Agreement was to reinstate the gold standard in a modified form and to bind the nations to its acceptance; and this has continued to be the declared purpose of the United States. But it has been sheerly impossible, even with American aid, to carry this purpose into effect.

This international control was intended to apply not only to adjustments of currency values, but also to every kind of exchange regulation affecting current transactions. Article VIII of the Bretton Woods Agreement imposed, after a transitional period, an absolute prohibition on all 'restrictions on the making of payments and transfers for current international transactions', and then went on to forbid all 'discriminatory currency arrangements or multiple currency practices' unless they were specifically authorized in the Agreement itself or were made with the approval of the directors of the Fund. Where such practices were already in force, there was provision for their gradual removal in consultation with the Fund.

These clauses did allow control to be exercised by individual countries over their foreign payments when these arose out of capital, as against current, transactions. It was indeed obvious from the first that the Plan could not work at all unless countries were allowed to control movements of capital across their national frontiers. But the freedom to control capital transactions did not include the right to use exchange control as an instrument for redressing an unfavourable balance arising out of current transactions. It was a condition of the entire scheme that each participating country must be prepared at all times to supply, in respect of current transactions, any quantity that might be demanded of any foreign currency issued by any other participating country. That is to say, each country had to bind itself to allow the free conversion of its own money at a fixed ratio into the money of any other participating country.

There was, indeed, an exception to this 'golden rule'. There had to be; for otherwise the whole scheme could have been speedily wrecked by a rush of claimants wishing to convert their holdings

of other currencies into dollars and thus to transfer their purchasing power to the American market. If such a rush had occurred, the supplies of dollars available at the fixed parity of exchange would soon have been exhausted, and the scheme would have collapsed. Accordingly, the Agreement made provision for dealing in a special way with the supply of 'scarce currencies'—by which was meant, in effect, dollars. When a currency has been formally declared by the directors of the Fund to be 'scarce' (but only then), any country may impose exchange restrictions on the supply of that particular currency through its Central Bank; but there are many safeguards in the Agreement limiting the extent and duration of the restrictions in question, and the right to impose any restriction at all is conceded only when the Fund has itself run out of means of replenishing its supplies of the currency that is 'scarce'.

In general, then, the Bretton Woods Agreement contemplated a currency system under which any money would be exchangeable at a fixed rate into any other, and there would be no special arrangements between particular countries to make mutual dealings easier than dealings with the rest of the world. The Agreements clearly envisaged the complete eventual disappearance of the 'sterling area', or of any other less than worldwide currency group; and even if the provision relating to 'scarce' currencies did have to be invoked, countries belonging to the Bretton Woods scheme were to be prevented from introducing, in respect of current transactions, any control at all over dealings in any currency other than that which had been formally declared 'scarce'. The intention to destroy the 'sterling block' was at that time unequivocal; and indeed the Americans made no secret of their dislike of such arrangements or of their determination to use the full weight of their financial power to ensure their abolition.

All this is, of course, the negative side of the Bretton Woods scheme, which was explicitly declared to have as one of its main purposes 'the establishment of a multilateral system of payments in respect of current transactions between members and the elimination of foreign exchange restrictions which hamper the growth of world trade'. The phrase implies that all restrictions, except those which are limited to capital transactions, do 'hamper the growth of world trade'. This is a highly questionable doctrine; but at the time it was maintained with the utmost tenacity by the American State Department, and was written decisively into the structure of the Bretton Woods Agreement.

We can now turn to the more positive provisions—to those on which must rest the claim, made in the text of the Agreement, that it was designed 'to facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy'. This claim, as far as it can be substantiated at all, rests on the provisions of the scheme for enabling countries to obtain temporary supplies of foreign exchange to meet current deficits by drawing upon the resources of the International Monetary Fund. The essential provision is that to each participating country is assigned a 'quota' which is normally to be revised every five years, with the proviso that no change in quota can be made except by a four-fifths majority, or without the consent of the member concerned. The quotas were thus made difficult to change. Each member, before drawing anything out of the Fund, must pay into it the full amount of its 'quota', partly in gold, and partly in its own currency—that is, by authorizing the Fund to draw on its own Central Bank up to the full amount involved. In normal cases, the proportion of the quota payable in gold was either one-quarter of the quota or one-tenth of the country's holding of gold and of United States dollars combined—whichever was the smaller. There were special provisions relating to countries whose territories had been overrun during the war; but these do not affect the general principle. The International Monetary Fund thus started off with a stock of gold, *plus* a stock of each currency amounting to at least three-quarters of each country's quota; and it was in a position, if it wished, to convert the gold into dollars or, indirectly, into any other currency of which it might need to replenish its supply.

On the Fund thus constituted each member is entitled to draw in order to meet demands which it cannot meet out of current resources directly accruing to it in the normal way of trade or other commercial transactions. But it is able to draw only within limits and subject to penalties if it draws more in other currencies out of the Fund than other countries are drawing of its own currency. The amount which a country is entitled to draw is equal to its quota; but not more than one-quarter of this total can be drawn in any one period of twelve months. On such drawings a charge of $\frac{3}{4}$ per cent. is made, payable in gold.

The International Monetary Fund will thus normally hold, of

each currency, a total made up of three-quarters, or more, of the quota of the country concerned, *plus* such sums as the country has paid in for the purpose of acquiring other currencies, *minus* such sums of the country's currency as other countries have drawn out. If the demands for all the currencies neatly balanced, the Fund would find itself holding of each of them exactly the amount originally paid in. On the other hand, if Great Britain, France, and a number of other countries buy dollars from the Fund and the United States does not buy an equal amount of their currencies, the Fund's holdings of sterling, francs, etc., increase, and its holding of dollars goes down. It is then authorized to replenish its supply of dollars by buying them in exchange for gold, or alternatively, if the United States will lend, to borrow dollars either from the United States monetary authorities or from any country which may have a surplus. If the Fund nevertheless runs short of dollars, the provisions relating to 'scarce' currencies—already described—can be brought into effect.

As the Fund exists to exchange one sort of currency for another, a fall in its holdings of dollars implies an increase in its holdings of some other money. This is where the penalties come in. If the Fund finds itself holding an amount of any currency in excess of the quota of the country concerned, it must levy a charge on the following scale on the country of whose currency it holds an excess:—

'(i) *On amounts not more than twenty-five per cent. in excess of the quota*: no charge for the first three months; one-half per cent. per annum for the next nine months; and thereafter an increase in the charge of one-half per cent. for each subsequent year.

(ii) *On amounts more than twenty-five per cent. and not more than fifty per cent. in excess of the quota*: an additional one-half per cent. for the first year; and an additional one-half per cent. for each subsequent year.

(iii) *On each additional bracket of twenty-five per cent. in excess of the quota*: an additional one-half per cent. for the first year; and an additional one-half per cent. for each subsequent year.'

It should be noted that all these charges are normally payable, not in the currency of the country concerned, but in gold. They are meant to discourage countries from falling into persistent deficit on their balances of international payments. There is, however, a relief clause, which lays down that, if a country's monetary resources amount to less than half its quota, it need pay in gold only that

proportion of the charge which its resources bear to half its quota, and may pay the balance in its own currency.

In the original Keynes Plan, there was a provision for penalizing not only countries which paid more of their own currencies into the Fund than other countries drew out, but also countries which failed to make use of their quotas to obtain other currencies—in other words, to penalize 'surplus' equally with 'deficit' countries. But this was too much for the Americans, and was dropped out of the final scheme, which thus penalizes only debtors and fails to recognize that any blame rests on creditors who fail to use their money in buying their debtors' goods. The debtors are not merely penalized, but are mulcted on a scale rising both with the amount and with the duration of their debt.

There is, of course, this to be said for the scheme. It did provide each participating country with an initial command of foreign exchange which it could use to meet a temporary disequilibrium in its balance of payments; and this would obviously have solved the problem if it could have been assumed that the disequilibria needing to be dealt with would be only of short duration and of relatively small amount. There are, however, three different kinds of disequilibrium which may express themselves in an adverse balance of current payments. The first and simplest of these is a mere short-term phenomenon arising out of such factors as a harvest failure or the exceptional depression of an industry on which a country largely depends—or even a merely seasonal disequilibrium, such as used regularly to affect the exchanges between Great Britain and the United States at certain times of year. For dealing with such problems the Bretton Woods machinery is obviously adequate. Secondly, there is a more serious disequilibrium, arising out of the war, which renders certain countries unable to finance their import requirements out of their current receipts from abroad until they have had time to re-build and re-adjust their economies. The mere fact that Great Britain found it necessary, side by side with the Bretton Woods discussions, to enter into negotiations with the United States for a very large dollar loan shows that, in this case at any rate, the credits made available under the Bretton Woods Plan fell a long way short of meeting the need—and indeed that it was not intended to deal with needs of the magnitude of those arising directly out of the war. Thirdly, there is a kind of disequilibrium that arises out of long-term conditions, and involves a long-period inability of a particular country to manage without external aid in covering current import

requirements. Austria was in this position for most of the period between the wars, and was sustained by repeated League of Nations loans as well as by foreign banking credits. With this third type of disequilibrium the Bretton Woods Plan is plainly not meant to deal directly; and there is in fact no way of dealing with it except either by long-term loans, of which the repayment is bound to be doubtful under the conditions postulated, by outright gifts, or by changes in the economy which will bring the balance of payments back into equilibrium, either by direct action to reduce imports or by currency readjustments or internal deflation, or by some combination of these methods. At Bretton Woods, the post-war disequilibrium was treated as being of the second type, whereas it really belonged rather to the third; and accordingly the inadequacy of the provisions was soon apparent.

The Keynes Plan, in its original form, was essentially reflationary. It proposed the creation of a new international money of account—*Bancor*—and the crediting to each country of an amount in *Bancor*, convertible at will into any national currency, based on the amount of each country's foreign trade before 1939. The Bretton Woods Plan, on the other hand, dropped the proposal for a new kind of money, and gave each country a fixed quota of credit on which it could draw. In the case of the United Kingdom this quota was fixed at 1,300 million United States dollars, or approximately £325 millions at the then rate of exchange; but in order to be able to draw up to this amount over a period of four years Great Britain had to pay over £80 millions—one-quarter of its quota—in gold, as part of its subscription to the Fund: so that the net addition to its credit as a result of the Plan was not £325 millions, but only about £244 millions, which was not nearly enough to meet the deficit of a single year under the conditions of the British economy at the time when the Plan was ratified. All other countries, except the United States, were given smaller quotas than the United Kingdom. The Keynes Plan, in its original form, would have given the United Kingdom a credit equal to 75 per cent. of the value of its pre-war foreign trade (and, of course, similar credits to other countries). This would have meant a credit of from £1,000 to £1,100 millions, according to the method used in calculating the value of imports and exports. Such a sum would have been in the event inadequate; but it would have borne some relation to the magnitude of the prospective deficit, whereas the sum made available under the Bretton Woods Plan was obviously neither here nor there in relation

to the deficits arising out of disequilibria of either the second or the third type. The evident intention of the Keynes Plan was to make unnecessary the negotiation of any huge inter-governmental loan by providing a new international type of credit on which all nations would be entitled to draw while they were re-adjusting their economies. The Bretton Woods Plan had a much more limited objective: it was designed to provide means of dealing with temporary disequilibria of the first type, but not with the much more serious disequilibria of the other two types.

The merits of the Bretton Woods Monetary Agreement must, indeed, clearly be judged in the light of this limited objective, and not by the test of its adequacy in dealing with the more serious forms of disequilibrium. In relation to these it was, taken by itself, quite manifestly inadequate, and intended to be so. It was in effect, in the minds of the Americans, who were primarily responsible for it, not so much a plan, complete in itself, as one part of a wider plan which included in addition proposals for the promotion of long-term foreign investment, for the regulation of the conditions of international trade on 'multilateral' and 'non-discriminatory' principles, and, as appeared later, for temporary loans to be made conditional on the borrowers accepting the obligations which were to be attached.

In the sequel, the inadequacy of the International Monetary Fund in relation to the actual post-war situation was speedily exposed. One important factor was the sharp rise in prices after the end of the war.* In the United States, the index of raw material prices rose from 65 in 1945 to 100 in 1948, and that of farm prices from 67 to 100, while the index for finished goods rose from 64 to 100. In the United Kingdom the index for raw materials rose over the same period from 63 to 100, but for finished goods the rise was only from 76 to 100. In 1946 the average prices of British imports were 110 per cent. above the 1938 level, and those of British exports 96 per cent. above: by 1948 the increase for imports was 185 per cent., and that for exports only 142 per cent. The 'terms of trade' had thus worsened from 108 to 117 (1938=100). This had occurred long before the Korean crisis, which carried the average price of British imports to 331 per cent. above that of 1938, and the price of raw material imports to 500 per cent. above, as against an increase of only 200 per cent. in the average price of exported manufactures and 203 per cent. for all exports. In 1951 the terms of trade had worsened to 141, and the ratio for raw material imports as against

* For the general movement of prices, see Table VIII, page 96.

manufactured exports to 200. It thus took twice as many exported manufactures to pay for a given quantity of imported materials. 1951 was of course an abnormal year; but even in 1950 the terms of trade stood at 124 against Great Britain as compared with 100 in 1938, and for manufactured exports as against raw materials at 159.

The change in the terms of trade meant a sharp increase in both the real and the money cost of imports, not only to Great Britain, but to many other countries as well; and at the same time the rise in prices generally made the Bretton Woods quotas utterly inadequate even for the purpose of tiding countries over their immediate post-war problems. The International Monetary Fund, which had been intended to serve as a major instrument for the restoration of commercial and financial prosperity, was reduced to quite minor proportions. With the advent of Marshall Aid—the direct outcome of the realization of the inadequacy of the Bretton Woods projects—it became unimportant as a source of funds for the needy countries.

This brings us to the second part of the document drawn up at Bretton Woods, which was based on the second White Plan dealing with long-term international lending. This second part was embodied in the agreement for the setting up of an 'International Bank for Reconstruction and Development'. This body was given a nominal capital stock of 10,000 million United States dollars, divided into 100,000 shares; but this large figure is in some degree misleading, as the Bank's power to make direct advances of capital was limited to 2,000 million dollars, and the rest of its nominal capital was designed to be applied only to guaranteeing loans for which the actual capital was to be raised elsewhere. The member States were to pay up in the first instance only 2 per cent. of the nominal amount of their holdings, this initial payment being due at once in gold or dollars, except in the case of countries which were overrun during the war. A further 18 per cent. of the nominal capital, payable in the currencies of the members, was to be called up as it was needed for financing the Bank's loans. The remaining 80 per cent. was not necessarily to be called up at all; but if any part of it had to be called, in order to implement guarantees given by the Bank, the amounts called were to be payable either in gold or dollars or in the currencies needed to meet the Bank's actual obligations. There was a provision whereby the Bank's total capital could be increased beyond 10,000 million dollars by a three-fourths vote of its governing board.

The major purpose of the Bank is thus the guaranteeing of private

foreign investments rather than the making of direct loans. The Bank can, however, participate in loans of which the major part is raised elsewhere. It makes loans itself only 'when private capital is not available on reasonable terms'; and its guarantees are also subject to the condition that the Bank must be satisfied that, in the prevailing market conditions, the borrower would be unable otherwise to obtain the loan on terms which in the opinion of the Bank are reasonable for the borrower. Loans can be guaranteed only when the Bank considers the rate of interest, the other charges, and the conditions of re-payment to be reasonable; and the Bank must in all cases make a reasonable charge for giving its guarantee. Moreover, wherever the borrower is not a State which is a member of the Bank, the State-member within whose territory the investment is to be made, or its Central Bank or other appropriate agency, must also fully guarantee both principal and interest.

It will be seen that the statute of the Bank was carefully so drawn as to prevent it from becoming a competitor of private enterprise in the making of foreign loans. It was indeed clearly contemplated that its own loans were to be primarily for purposes which were unlikely to appeal to private investors, either because of their scope or because they were to be placed in countries which had a low standing in the capitalist investment market. It is not clear how this was meant to work out when the Bank participated jointly with private investors in a particular loan. Both loans and guarantees are in normal cases tied to specific projects of capital development or reconstruction; and the Bank has to 'make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted . . . and without regard for political or other non-economic influences or considerations'. It is further laid down that 'the Bank and its officers shall not interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member or members concerned'. 'Only economic considerations', it is stated, 'shall be relevant to their decisions.'

Actually, of the 10,000 million dollars designated as the Bank's nominal capital, only 8,800 million were assigned at the Bretton Woods Conference to the 44 countries there represented, the balance being left to be assigned to other countries which might thereafter enter the scheme. Out of this 8,800 million, the United States became responsible for 3,175 million, and was thus much the largest shareholder.

Such is the new Bank as it was set up at the Bretton Woods conference. It remains to consider, in relation both to the Monetary Fund and to the Bank, where, under the Bretton Woods Agreements, the actual control is destined to lie. No one country, of course, has a majority vote; but on both bodies the United States has much the largest voting power—considerably exceeding the total voting power of the British Commonwealth. The biggest participants, after the United States, were to be the United Kingdom and the Soviet Union (which finally decided not to sign the Bretton Woods Agreements), followed at some distance by China, France, and India. Under both parts of the scheme the five largest participants were given special privileges. Both the Fund and the Bank were put under Boards of Governors to which each participating country was to appoint a single Governor (and a substitute to act in his absence); but the main administrative functions were given to a body of Executive Directors, who appoint from outside their own number and that of the Governors a Managing Director (called a 'President' in the case of the Bank). Of these Executive Directors, numbering twelve for each body, the five largest participants appoint one each, and the other participants choose the rest by a system of proportional representation. There is a special provision in the case of the Monetary Fund whereby for certain purposes the vote of a creditor country is increased and that of a debtor reduced; but in general the voting power is based on the quotas assigned to the various countries.

Even in 1954 it is not at all easy to assess the accomplishments of the International Bank. There are provisions in its statute which direct it 'to promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living, and conditions of labour in their territories' and also 'to arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful projects, large and small alike, will be dealt with first'. It was evidently meant that the Bank should work in closely with the Monetary Fund, and should encourage the conversion of surpluses arising on current account into long-term foreign investments, in such a way as to bring the total balance of payments of each country as nearly as possible into equilibrium. But there was no assurance that this would be achieved; and the

extent to which it would be practicable to attract private investment into areas needing development would obviously depend on the estimates formed by American capitalists of the likely profitability of such transactions—which in its turn would depend on the success of the potential borrowing countries in restoring their economies and in expanding their export trade. It was clear that the Bank was meant to operate on 'sound, commercial principles', and not to make loans on philanthropic motives or even where the prospects of return looked seriously doubtful. Indeed, it was explicitly laid down in respect of both loans and guarantees that 'the Bank shall pay due regard to the prospects that the borrower . . . will be in a position to meet its obligations', and that 'the Bank shall act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole'.

It is a curious and perhaps revealing fact that the entire wording of the scheme appears to assume that the projects to be financed would in each instance be confined to the territory of a single country. Nothing is said to suggest that, for example, the Bank might undertake the financing of supra-national projects through any sort of special body constituted on the lines of the Tennessee Valley Authority. Doubtless, such projects could be brought within the scope of the Bank's operations by putting behind them the joint guarantee of the States concerned, or by breaking them up into a number of partial projects each guaranteed by one of these States. But the second of these methods is open to very great objections; and it is by no means clear how the first method was meant to be squared with the wording of the Bretton Woods documents.

It was obvious from the first that the practical success of the International Bank in achieving any large results was bound to depend on the degree of success with which the leading countries managed to adjust their political differences and to establish a basis for co-operative economic action. Moreover, the two halves of the Bretton Woods Plan were meant to go together; and it was contemplated, though not absolutely laid down, that the membership should be the same in both cases and should cover in effect the whole world, including the Soviet Union. In the event, however, the Soviet Union held aloof; and both parts of the plan developed under predominantly American influence. Moreover, the lack of balance in the world economy was soon shown to be very much more serious, and certain to be of much longer duration, than was at all envisaged at the outset. Fresh measures had to be taken, one

after another, to prevent the collapse of the monetary structure of the deficit countries; and these further steps were taken mainly outside both the Fund and the Bank—first in the American and Canadian loans made to Great Britain in 1946, and subsequently in the successive plans for economic and military aid to the deficit countries which, in order to receive this aid, accepted inclusion in the American sphere of influence and thus lined up against the Soviet Union and its satellites and allies.

Accordingly it seems best to defer consideration of the achievements of the Fund and the Bank until we have considered the effect of these other proceedings, which have been of much greater short-run importance.

XVIII

POST-WAR

CLOSE upon the Bretton Woods Plans followed the negotiations which led up, in December 1945, to the publication of a proposed Financial Agreement between the Governments of the United States and of Great Britain. This document contemplated the granting to the United Kingdom of an American loan of 3,750 million dollars, to be drawn upon at any time between the entering into force of the agreement and the end of the year 1951, and to bear interest at 2 per cent. No interest was to be payable until the end of that year; but from then the loan was to be repaid in fifty annual instalments, including both principal and interest, with a view to complete liquidation of the debt by the year 2000. In certain circumstances, to be described later, the interest payable in a particular year could be cancelled, but not the instalment due towards repayment of the principal.

The purpose of this loan was clearly laid down. It was 'to facilitate purchases by the United Kingdom of goods and services in the United States, to assist the United Kingdom to meet transitional post-war deficits in its current balance of payments, to help the United Kingdom to maintain adequate reserves of gold and dollars, and to assist the Government of the United Kingdom to assume the obligations of multilateral trade, *as defined in this and other agreements*'.

The sting of this clause was in the tail. It was made a condition of the loan that the United Kingdom should adhere to the Bretton Woods Plans and should thus place the management of its currency under international regulation and agree to abstain from foreign exchange control save in respect of capital movements; and in addition to this the United States Government simultaneously put forward a remarkable document entitled *Proposals for Consideration by an International Conference on Trade and Employment*, and required that the British Government should pledge itself to give full support to these proposals. This pledge was made a further condition attached to the loan; and both the adhesion to the Bretton Woods Plans and the pledge had to be given in advance—that is, before the American Government would even agree to submit the loan to Congress for ratification, without which it could not be granted.

Actually, in a *Joint Statement* issued by the two Governments in December 1945, the British Government, in terms obviously dictated to it by the American State Department, affirmed that it was 'in full agreement on all important points in these proposals', and went on to say that it 'accepts them as a basis for international discussion, and will, in common with the United States Government, use its best endeavours to bring such discussions to a successful conclusion, in the light of the views expressed by other countries'. The closing words of this far-reaching sentence doubtless indicate a hope on the British side that the hostility of other countries to some of the American proposals would in fact prevent their adoption and would thus relieve the United Kingdom of some of the more onerous burdens which it pledged itself to assist in imposing; but the pledge to 'use its best endeavours' to back up the American proposals was made unequivocally binding.

Thus, the loan proposal of December 1945 was by no means an ordinary commercial bargain. The Americans, in addition to exacting interest at what can be regarded, for such a loan, as a reasonable commercial rate, wrote into their offer conditions which amounted to an entire subordination of British commercial and monetary policy to American ideas, and to an acceptance of American hegemony in international monetary and commercial affairs.

Before we go on to consider the implications of the American *Proposals* dealing with trade and employment, it will be best to complete the account of the financial conditions attached to the loan itself. In the first place, it should be observed that the proposed Financial Agreement included, besides provision for the loan, an annex embodying a complete settlement of outstanding obligations arising out of Lend-Lease, Reciprocal Aid, the disposal of surplus war property in the United Kingdom belonging to the United States, and all similar claims arising out of the common war effort. This proposed settlement did not extend to obligations incurred by the United Kingdom in making purchases in America not covered by the Lend-Lease or Reciprocal Aid Agreements; but it did, subject to certain secondary adjustments, fix the British obligation on account of Lend-Lease and the other agreements referred to, and of property claims, at 650 million dollars, and it laid down that this debt should be discharged by annual instalments, payable from 1951, on the same terms as those laid down in respect of the loan.

In the matter of Lend-Lease there are, of course, two views. The decision of the United States to stop all Lend-Lease aid from the

very moment of the cessation of hostilities was unexpected in the United Kingdom, where it was widely felt that a continuance of American aid during a transitional period might well have been regarded as a reasonable offset to the United Kingdom's burden in carrying on the war in its early stages without the help of the United States. If, however, the Americans did not take this view, the settlement was as fair as could be looked for, as a way of dealing with the debts piled up for supplies sent or in transit from the United States after VJ day. It was at any rate satisfactory to the British Government to know where it stood in relation to these American claims—even if it was not easily apparent how the repayment of 650 million dollars was actually to be made, especially in view of the addition to it of the still larger repayment that would have to be made under the loan agreement.

This wider issue of the possibility of repayment had better be considered as a whole, when the full terms on which the loan was based have been set down. The repayment in respect of the loan itself was to be made in fifty annual instalments of nearly 32 million dollars each for each 1,000 million dollars of the loan actually drawn out by the United Kingdom. This would mean, if the whole amount were to be drawn, rather more than £30 millions a year, *plus* the amount due on account of the Lend-Lease Agreement. There was, however, the qualifying clause which allowed payment of interest, but not repayment of the principal, to be waived in certain circumstances. This clause was to come into force, on a request from the United Kingdom, in any year in which 'the International Monetary Fund [i.e. under the Bretton Woods Plan] certified that the income of the United Kingdom from home-produced exports *plus* its net income from invisible current transactions in its balance of payments was on the average over the five preceding calendar years less than the average annual amount of United Kingdom imports during 1936–38, fixed at £866 millions, as such figure may be adjusted for changes in the price level of these imports'. There were certain qualifications attached to this formula; but they did not affect the main principle.

Thus, the 'waiver' of interest could be invoked only in face of a long-sustained deficit in the British balance of payments, and only in relation to the pre-war level of British imports. Any additional imports acquired either on account of a larger population or an improved diet, or in order to provide materials for an increased volume of exports, would not count towards entitling Great Britain

to a remission of the current payment of interest. If, however, the payment was waived, it was to be cancelled entirely, and not merely carried over to subsequent years.

There were a number of further conditions. No part of the American loan was to be used in discharging existing obligations to other countries—which meant that none of it could be applied to lessening the amount of Great Britain's sterling debts to India and other countries. Moreover, the British Government had to pledge itself not, before the end of 1951, to borrow from any Government within the British Commonwealth on terms more favourable to the lender than those of the American loan. The 'waiver' of interest could not be claimed unless payments in respect of sterling debts and of future loans from Commonwealth Governments were reduced in proportion.

Nor was this nearly all. The United Kingdom was forced to pledge itself, within only one year of the loan agreement entering into force,* entirely to put an end to the wartime 'sterling-dollar pool'. This pool was an arrangement under which certain countries belonging to the 'sterling area'—in effect, the British Commonwealth, except Canada,† with Egypt and Iraq added—pooled all their dollar receipts from current trade and drew in agreed proportions out of the pool for meeting purchases which needed to be paid for in dollars. The effect of this was that countries belonging to the pool could pay for United States goods only within the limits of their right to draw out of the pool. The American Government made it a condition of the loan that this arrangement should be ended, and that each sterling country should be entirely free to spend its own current dollar receipts where and as it pleased. Moreover, the same condition of freedom to spend anywhere was to apply to the *sterling* receipts of the countries belonging to the sterling area: so that each such country would be entitled to call upon the United Kingdom to convert sterling paid by Great Britain for British imports into dollars, which could be used to buy American instead of British exports.

The Agreement went on to prohibit Great Britain from applying any exchange control to purchases in Great Britain of United States goods, or to the use of current sterling balances belonging to American residents. It then proceeded to a still more sweeping

* Unless a later date was agreed to by the United States.

† And for most purposes, South Africa, which is hardly more than a nominal member.

clause forbidding, from one year after the Agreement came into force, all exchange controls in respect of current transactions. This prohibition did not apply to balances already accumulated—i.e. existing sterling debts, or to restrictions agreed on by the United States under the 'scarce currencies' clause of the Bretton Woods Plan*; but it was sweeping in its implications and had the sinister effect of shortening to a single year the transitional period contemplated in the Bretton Woods Plan.

Even this was not enough. Clause 9 went on to bind the signatories, if they imposed any quantitative control over imports, to do so only 'on a basis which does not discriminate against imports from the other country in respect of any product'. This clause, which was fixed to come into operation at the end of 1946, irrespective of the date at which the loan itself might be endorsed by Congress, was designed to rule out any attempt by the United Kingdom directly to regulate imports in such a way as to give a preference to those coming from other parts of the sterling area. The indirect method of achieving this result, as we shall see, was to be barred by the *Proposals on Trade and Employment*.

Finally, the Financial Agreement dealt with the problem of the accumulated sterling debts of Great Britain. Although the method of settling these debts was surely no affair of the United States, the American Government required the United Kingdom Government to deal with them in a particular way. The sterling debts were to be divided into three parts: one part to be released at once and made freely convertible from sterling into any other currency for use in current transactions; a second part to be released and made payable, on the same conditions of free convertibility, by annual instalments beginning in 1951; and a third part 'to be adjusted as a contribution to the settlement of war and post-war indebtedness and in recognition of the benefits which the countries concerned might be expected to gain from such a settlement'. This was in effect a requirement that the British Government should do its best to bilk India, despite an existing agreement under which the costs of the war had already been shared between India and Great Britain, and in face of the privations inflicted on the Indian people by the diversion of Indian resources to the war effort, and of the urgent need of India for capital imports in order to improve its productive resources and begin upon an effective policy for raising the Indian standards of living.

* See page 357.

Such were the explicit terms of the Financial Agreement under which the United States Government declared its willingness to ask the approval of Congress for a loan to Great Britain. It remains to consider the further conditions which were attached to the offer. One of these was that Great Britain should become a member of the international monetary organizations set up at Bretton Woods, and should thus assume all the obligations in respect of currency regulation outlined in the preceding chapter. Even more serious was the enforced acceptance, on all important points, of the American *Proposals on Trade and Employment*; for these went a long way beyond either the Bretton Woods Plan or the Financial Agreement in restricting British freedom to follow economic policies independent of those of the United States, and in tying the economic fortunes of Great Britain tightly to American fortunes, in such a way that Great Britain would be left at the mercy of American economic fluctuations and of changes in American economic and fiscal policies.

It is true that the *Proposals* opened, after a general preamble relating them to the Bretton Woods International Monetary Agreement and to the establishment of the United Nations Food and Agriculture Organization, with certain resounding declarations concerning employment. It was affirmed that 'in all countries high and stable employment is a main condition for the attainment of satisfactory levels of living', and also 'essential to the expansion of international trade on which the full prosperity of these* and other nations depends . . . and therefore to the preservation of world peace and security'. It was then laid down that 'each of the signatory nations will take action designed to achieve and maintain full employment within its own jurisdiction, through measures appropriate to its political and economic institutions', and that 'no nation will seek to maintain employment through measures which are likely to create unemployment in other countries, or which are incompatible with international undertakings designed to promote an expanding volume of international trade and investment in accordance with comparative efficiencies of production'.

This was all very fine; but the trouble about it was that the United States Government took for granted, as British representatives were apt to do in the great days of British commercial supremacy, that whatever suited the United States must necessarily suit everybody else, or at any rate must be of unquestionable benefit to the world as a whole. Nay more—the British, in their days of

* I.e. the major industrial and trading nations.

supremacy, at any rate practised what they preached and opened their home market wide to the products of all the world; whereas the Americans were preaching the gospel of 'freedom' from behind their own high tariff wall, and were asking the rest of the world to believe that somehow, mysteriously, enough foreign products would be allowed into the United States over this tariff wall to enable other countries to pay for all the exports the Americans were prepared to send them—or at all events that any gap would be comfortably and steadily bridged by American foreign investments, for which it was not easy to see how, in the aggregate, the Americans could ever expect to receive any return. In the name of condemning all 'discrimination' and insisting on the exclusive operation of the rule of comparative efficiencies of production—save for the gigantic exception of the tariff—the United States was denying to other countries, and particularly to Great Britain, the right to adopt measures designed, not to restrict international commerce, but to expand it by mutual bargains that would allow exchanges otherwise impracticable to take place, and would not leave every major country at the mercy of every fluctuation in the American economy.

The fine words of the paragraphs in the *Proposals* dealing with employment—which were an echo of earlier international declarations made in the days of President Roosevelt—were entirely neutralized and overborne, as we shall see presently, by the subsequent clauses.

The operative part of the *Proposals* began with the project of establishing an International Trade Organization of the United Nations, and with laying down its objects. After enumerating a number of general principles, with the alleged purpose of removing hindrances to the development of international trade, the document got down to brass tacks by dealing with 'tariffs and preferences'. Under this head it proposed arrangements for the *substantial reduction* of tariffs and for the *elimination* of tariff preferences. In other words, the Americans were to keep their tariff, and were merely to bargain with other countries for mutual reductions—as they have since done, to a not inconsiderable extent, though always on a strictly temporary footing. As against this the countries of the British Commonwealth were to be compelled to abolish altogether their mutual tariff preferences, as if there were something immoral in countries establishing closer mutual trading relations one with another than with the whole world—as indeed the Americans appear

to think there is.* It was explicitly laid down that existing commitments were not to be allowed to stand in the way of action with respect to tariff preferences, and that all reductions in most-favoured-nation tariffs 'will operate automatically to reduce or eliminate margins of preference'. It was also proposed that margins of preference were in no case to be increased and that no new preferences were to be introduced. It was added that, in respect of tariffs but not of preferences, countries might take emergency action 'to prevent sudden and widespread injury to the producers concerned'. In other words, any country, if it took off or reduced a tariff, might put it back when it pleased; but under no circumstances might Great Britain put back a preference that had once been given up or modified.

The *Proposals* then went on to deal with 'quantitative trade restrictions'. This part began with a general denunciation and prohibition of 'quotas, embargoes, or other quantitative restrictions', subject only to named exceptions. Restrictions arising out of shortage of shipping space or of materials due to the war might be kept on for up to three years after the termination of hostilities, but no longer except with the concurrence of the proposed International Trade Organization. *Export* restrictions might be imposed to relieve 'severe shortages of foodstuffs or other essential products'. Either import or export quotas might be enforced in connection with inter-governmental agreements regulating the trade in particular commodities. Finally, in the case of agricultural products only, import quotas were allowed if they were accompanied by parallel restrictions on home production, or in order to get rid of temporary surpluses of home produce. If, however, such import quotas were imposed, they had to be 'allocated fairly, on the basis of imports during a previous representative period'—in other words, they must not be used to increase the *proportion* of imports drawn from a particular country. Great Britain was to be forbidden to use quotas as means of increasing purchases within the sterling area: nor was it to be permissible to use them, whatever the pressure on the balance of payments, in such a way as to 'reduce imports relatively to domestic production' except under certain stringent conditions.

These conditions were, first, that during the 'period of transition' quota restrictions designed to protect the balance of payments must not be more restrictive than the conditions laid down for the same

* Unless the countries to be penalised are on the wrong side of the 'iron curtain'.

period in respect of monetary restrictions under the Bretton Woods Plan; and secondly, that they must be entirely 'non-discriminatory' —that is, must not encourage imports from any particular country. All quotas were to be based on the actual amounts of trade done with the various countries over a period of preceding years; and where import licences were used in place of quotas, the same principle was to be observed. Where the State itself was the importer, through a 'State-trading organization', the same rules were to apply—in other words, the State was not to be free to purchase where it pleased, but was to be bound to distribute its orders on the basis of the amounts actually bought from various countries in previous years.

The clause just referred to applied only where total imports were being restricted. This, however, might have been held to leave States free to buy where they chose as long as it could not be shown that they were restricting their total purchases. This would not have suited the Americans, who wanted to tie down state-trading organizations to behave as if they were private traders in search of maximum profits. Accordingly, a further series of clauses dealt with state trading generally. This part of the *Proposals* began by laying down that States which engaged in trade 'should undertake that the foreign purchases and sales of their state-trading enterprises should be influenced solely by commercial considerations, such as price, quality, marketability, transportation, and terms of purchase or sale'. Further provisions followed, all designed to ensure that state-trading monopolies should not be used by the States that set them up as the instruments of any sort of planning of foreign trade. There followed a clause which bound States not to use exchange control as an instrument of trade regulation and required membership of the Bretton Woods International Monetary Fund as an assurance against such action.

Other clauses dealt with subsidies. These were not forbidden, but only made open to comment by the proposed International Trade Organization. It was, however, laid down that States must not subsidize exports in such a way as to sell goods more cheaply in foreign than in their home markets. It was further prescribed that no country must use an export subsidy to raise its share of world trade in any commodity above the share it had before the subsidy was given.

Next in order came a series of exceptions. The most important of these allowed restrictions 'necessary to public morals' (e.g. on the

trade in drugs); restrictions on the 'traffic in arms'; restrictions on the import or export of gold or silver; restrictions 'undertaken in pursuance of obligations for the maintenance of peace or security' (e.g. embargoes ordered by the United Nations or imposed by the United States on other countries under such subsequent measures as the 'Battle Act' of 1951); and restrictions on the trade in works of art or national treasures of historic interest. Then came a clause which ruled out any action to establish special preferences or close trading relations between a metropolitan country and its colonies; and a further clause which allowed countries to form 'customs unions', subject to consultation with the International Trade Organization, and to compliance with 'certain agreed criteria', which were, however, nowhere defined.

The remainder of the American Proposals fell into three parts. Chapter IV proposed international action to curb restrictive business practices 'such as combinations or agreements to fix prices and terms of sale, divide markets or territories, limit production or exports, suppress technology or invention, exclude enterprises from particular fields, or boycott or discriminate against particular firms'. This part was unexceptionable, however difficult it might be found to give its provisions practical effect. Chapter V dealt with 'intergovernmental commodity arrangements'. It was concerned exclusively with primary products, and laid down that, where difficulty arose over the marketing of any particular commodity, an international effort should be made to increase consumption; but that, if this was not enough, an inter-governmental conference representing the countries concerned as producers or consumers might agree on a scheme for restricting production. There were elaborate clauses defining the conditions under which such schemes were to be allowed; but they are not closely enough related to the main subject of this chapter to be described here. Nor is it relevant to enter into Chapter VI, which made elaborate proposals for the constitution and working of the International Trade Organization.

Enough has been said, I hope, to give a fair idea of the relevant parts of the American *Proposals on Trade and Employment*, with which the British Government, as a condition of getting the projected loan, was compelled in December 1945 to assert its 'full agreement on all important points' and to give its promise to 'use its best endeavours' to persuade other nations to agree. It is simply unbelievable that the British Government did in truth agree; and when the loan came under debate in the British Parliament in the

same month their spokesmen made hardly any pretence that this was so. The loan proposals, with all the conditions attached to them by the American Government, were recommended for acceptance, and were accepted, on the ground that to get the loan on almost any terms was preferable to going without it, and that there was many a slip betwixt the bitter cup of the American Trade Proposals and the actual drinking, because the Proposals would have to run the gauntlet of an International Trade Conference which would probably reject most of them out of hand. In my view, this hope of avoiding performance by no means justified the British Government in pledging its support to a policy which it must have known to be entirely unworkable; but most Members of Parliament were persuaded to the contrary, and accepted the Government's advice, moved partly by genuine doubts of the possibility of getting through the next few years without the loan, partly by a genuine desire to keep on good terms with the Americans, however dictatorially unreasonable they might be, and perhaps most of all by a fear that the Labour Government would forfeit its electoral popularity if it had to impose really heavy privations on the British people.

This raises a number of questions. First, how unreasonable and how onerous were the conditions which the Americans attached to the loan—apart from the possibility that Congress, before agreeing to ratify it, or subsequently, might add others? Secondly, if the conditions were regarded as too onerous, what would really have been involved in doing without the loan? Thirdly, what was to happen if, the loan having been granted, it appeared plainly at some future date that its conditions could not possibly be observed, or at least could not be observed without national disaster?

It was arguable in 1945 that, given time for full recovery from the effects of the war, the payment to the United States of an annual sum of £30 or £40 millions a year in gold or dollars would not be impossible, provided that (*a*) world trade as a whole was prosperous and expanding; (*b*) Great Britain kept full freedom so to regulate international trade as to avoid unduly heavy commitments to provide dollars for other purposes; and (*c*) the United States did not, by high tariff policies or other forms of refusal to buy, make payment impossible. A lower, or a somewhat higher, rate of interest would not have made a great deal of difference. The factors that were bound to determine the practicability of repayment were mainly these three, and also, of course, the efficiency of British industry in producing goods and services for export.

The quarrel, then, of those who objected to the loan scheme was not mainly with the proposed rate of interest or terms of repayment. It was either with the further obligations imposed in the Financial Agreement itself, or with the obligations of the Bretton Woods Plan, to which adhesion was required as a condition of getting the loan, or to the American *Proposals on Trade and Employment*, or, or course, to more than one of these. On the question of Bretton Woods British opinion was sharply divided. Some favoured it, especially in the City, which sets a high value on international monetary stability: some opposed it, especially among those who regarded national freedom of financial regulation as indispensable for the pursuance of full employment. There were many among the supporters of the Bretton Woods Plan who held that Great Britain could not possibly accede to it unless the loan were forthcoming, because without the loan it would be out of the question to get along except by controlling the exchanges in respect of current as well as capital transactions, and by making every possible effort to maintain the sterling area as a united currency group with full freedom of independent action. This, indeed, was evidently the official view; for the Government announced that Great Britain, though signing the Bretton Woods Agreements, could not maintain membership of the International Monetary Fund unless the loan were granted.

Even among advocates of 'Bretton Woods,' serious misgivings were felt at the clauses of the Financial Agreement which reduced to a year or less the transitional period at the end of which current transactions had to be freed from exchange control, on the ground that even with the loan, subject as it was to restrictions on its use, Great Britain could not possibly be in a position to meet the dollar claims that would promptly flow in if the restrictions were removed within so short a time. It was also felt that the obligation thus placed on Great Britain would very seriously limit British power to unfreeze any substantial part of the accumulated sterling balances, and would thus work out unfairly to other creditors of Great Britain, and above all to India.

The strongest objections of all, however, were felt to the *Proposals on Trade and Employment*, or rather to the trade part of them, read in conjunction with the financial and monetary conditions to which they were a sequel. The more Great Britain was bound to refrain from protecting the balance of payments by monetary action, the greater would be the necessity of protecting it in other ways. The more dollars Great Britain had to supply, in payment not only for

British imports and of debts due to America, but also by freeing sterling for dollar purchases by other countries, the greater would be the need to regulate imports in such a way as to direct British purchases from dollars to currencies easier to obtain, and with this in view to enter into national bargains with Commonwealth and other countries for the exchange of goods and services. These needs seemed obvious enough: yet the Proposals barred every road by which Great Britain could hope to get the balance of payments back into equilibrium or to acquire by means of exports the imports without which a fall in the standard of living would be unavoidable.

It was officially estimated in 1945 that, in order to balance the international accounts, Great Britain needed to increase the *volume* of exports by about 75 per cent., exclusive of any further international obligations that might have to be assumed. In the statistics presented by the British delegation to the Americans during the loan negotiations, it was shown that in 1945 the net proceeds of British overseas investments had fallen to less than £100 millions, compared with about £250 millions at a much lower price level before the war, and that, including the accumulated sterling debts, there had been a decrease of over £4,000 millions in the total net value of British property abroad—or, in other words, that Britain's creditor position had been in effect wiped out, so as to leave nothing but the current proceeds of British exports and exported services to meet the cost of imports and of any further debts that might have to be incurred. It was shown that internal 'disinvestment' in Great Britain, including physical destruction by war damage, loss of shipping, and deterioration of productive capacity through non-renewal of plant, amounted to about £3,000 millions; so that in total the British economy was well over £7,000 millions the poorer for the war. It was shown that British expenditure on consumption had fallen, as a result of the war, from 87 per cent. of the national income in 1938 to 57 per cent. in 1944, and that British gold reserves had decreased from £864 millions in 1938 to £453 millions in 1945, whereas the external debt had risen from £760 millions to £3,355 millions—so that the gold still held was very far from being absolute British property. Finally, it was shown that, because of concentration on the war effort, British exports had fallen in 1944 to 30 per cent. of the 1938 volume, and in money value, despite increased prices, from £471 millions to £258 millions.

These figures sufficiently measure the extent of the economic difficulties which faced Great Britain at the end of the second World

War. Obviously, they meant that, however energetically the problem of reviving the export trade might be taken in hand and however far, within practicable limits, austerity might be imposed on the consuming public, there was bound for some years at least to be a continuing deficit in the British balance of payments, even if nothing were done—and obviously something had to be done—to release some part of the accumulated sterling balances for use by the creditors of Great Britain, such as India, in their own schemes of economic development, as well as to meet deficits in their immediate balances of payments on current account. Obviously, further credits from one source or another were imperative; and, no less obviously, the United States was in by far the best position to provide them, in view of its overwhelming creditor position and of its need to produce for export on a scale much exceeding its willingness to receive imports in exchange. If the United States would not grant credits without imposing conditions that would both make repayment impossible and positively prevent the borrowers from taking the measures necessary for long-term recovery, where else could the requisite immediate credits have been found?

Canada was in a position to provide something, but not on the scale required. Indeed, a loan from this source was actually being negotiated at the same time as the discussions were proceeding with the United States; and a Canadian loan to Great Britain of £312 millions was approved in May 1946, side by side with the loan from the United States. South Africa, the world's largest source of newly mined gold, was also a possible source of supply. The willingness of Argentina to extend further credits could be ruled out: indeed, the Argentinians soon spent their surplus and became involved in exchange difficulties of their own. Obviously nothing more could be expected from India, which stood in urgent need to draw upon the existing sterling balances. It was, indeed, all too plain that Great Britain could not hope immediately after the end of the war to procure the imports needed for maintaining full employment at the existing standards of living—much less for an improved standard—without help from the United States in footing the bill. Many other countries were in the same difficulty. Given time, and help in meeting the immediate deficit, it was reasonable to hope that the British economy could be made productive enough to achieve these things, but only on two conditions. These were (*a*) that *either* the United States should so alter its readiness to receive manufactured imports

as to make possible an immense expansion of sales of British goods in the American market, *or* Great Britain should replace a large part of its dollar imports by imports from countries which were prepared to receive British goods in exchange; and (*b*) that in order to bring about the shift involved in replacing dollar imports, Great Britain should have the fullest freedom to negotiate bilateral (or less than universal) exchange agreements, and to discriminate between supplying countries. Such agreements and discriminations would evidently have needed to be directed largely to developing exchanges within the sterling area and especially between Great Britain and the Commonwealth countries as producers of foodstuffs and materials. They would have needed to include increased preferences for Commonwealth trade wherever these could be used to stimulate reciprocal exchanges. These preferences are a matter not only of tariffs but also of quotas where quantitative regulations are required; and to the extent to which the State itself acts as importer, they are also a matter of the policy followed by public import boards and similar bodies. All these forms of preference the British Government had to agree to aid the United States in abolishing under the terms of the American *Proposals on Trade and Employment*. No doubt, even without preferences, the Dominions would have continued to sell large supplies to Great Britain—as long as Great Britain had the means of paying for them. But clearly, in the absence of large loans from some source, Great Britain would not have had the means. Accordingly, in the absence of an American loan, the Dominions and the other countries concerned would have had to divert a considerable part of their exports elsewhere or to reduce their production, if they could not find alternative markets. The British standard of life would have been seriously reduced; and in addition shortage of necessary materials would have rendered it impossible to maintain full employment or to take the steps necessary for a recovery of British productive capacity. It may be thought that, immediately, exporters would have found no great difficulty in view of the almost universal shortages that needed to be made good. But Great Britain was by no means alone in suffering from a lack of the means of paying for necessary imports; and a curtailment of British purchases would obviously have worsened the purchasing power of other countries and narrowed the total market, so that, unless the United States had been ready to buy up the goods Great Britain could no longer afford, or to supply other countries with the means of buying them, the displaced goods could not have been sold at all.

World depression and world famine would have ensued together. There would have been a general scramble on the part of the deficit countries to reduce their imports, just as there was after 1931, but on an even larger scale.

The Americans, of course, were well aware of this, and of the need to take some step that would place in the hands of the deficit countries enough buying power to prevent a catastrophe. A part of the gap they hoped to fill by means of UNRRA, and other parts by means of the International Monetary Fund and the International Bank. But they were far indeed, in 1945-46, from realizing either the width of the prospective gap or the time that would be needed for bridging it. With UNRRA bringing short-term help to the more seriously devastated and impoverished areas and with Bretton Woods to give each country an immediate trading credit, they cherished vain hopes of a speedy return to 'normality'; and when they saw that these measures would not suffice to prevent collapse, they still thought that by advancing a sizeable loan to Great Britain on their own terms they could not only hold up the sterling rate of exchange and prop up the threatened British economy but also, through Great Britain, rescue the other deficit countries. The loan to Great Britain was meant to be used, not only to 'save the pound', but also, by being passed on to other countries, to give them too a sufficient breathing space for recovery.

Thus, in effect, Great Britain, in accepting the loan from the United States, was made responsible for meeting the demands of other countries for the means of paying for imports, as well as those of the British market. It is no wonder that, in these circumstances, with prices rising fast and the 'terms of trade' turning seriously against the industrial countries, the borrowed money was speedily paid away. There was a bottomless pit of demand into which it could be poured; and the moment the control over the supply of dollars in exchange for sterling was removed in respect of current payments, nothing could stop a run on the pound that would have swept the loan away even had it been a good deal bigger than it was. When that happened, and convertibility of sterling had been perforce abandoned within a few weeks of its resumption, the need for much more extensive help was realized, and after a short interval Marshall Aid was introduced. Instead of further loans, there had to be for the most part outright gifts; and instead of Great Britain acting as the intermediary between the United States and the other countries concerned, the aid had to be

given directly to a number of countries. But before this was done, Great Britain had been made the victim of the complete miscalulations of the world situation in 1945, and had been compelled to incur not only an additional debt burden which it could ill afford, but also a series of attached obligations which threatened disastrously to hamper it in bringing back its external trade into a condition compatible with its long-run needs.

The tardy ratification by the United States Congress in May 1946 of the Financial Agreement of 1945 staved off an immediate world crisis. But the granting of the loan by no means disposed of the major questions that have been discussed in this and the preceding chapter. From May 1946 it had to be assumed that Great Britain, in pursuance of the undertakings given by the British Government in connection with the loan, would become an active partner in the Bretton Woods International Monetary Fund, would comply with the obligations of the Financial Agreement in respect of a speedy liberation of the exchanges for current commercial transactions, and would support the United States Government's Trade and Employment proposals when and if the projected International Trade Conference met to consider them. Great Britain was thus pledged to support the abolition of trade preferences as part of a scheme of multilateral trading that could presumably come into force only on a basis of widespread international agreement. The Dominions, as self-governing States, were in no way committed to follow Great Britain's lead in this matter; and it was evident that many parts of the American proposals were likely to meet with opposition from other countries. It was obvious from the outset that they stood no chance of being accepted by the Soviet Union, which was certainly not going to agree to manage its state trading in accordance with the commercial profit-seeking principles demanded by the United States, or to renounce discrimination in its relations with other countries. It may now seem evident that the proposals of 1945 were never meant to bring in the Soviet Union or its allies, and indeed that they were the beginning of a cold war against 'un-American' ideas concerning monetary and commercial policy. But this was not so clear in 1945, when lip-service at any rate was being paid to ideas of economic collaboration on a world-wide basis. Great Britain's commitment under the trade proposals was clear: the delegates of the United Kingdom at any International Trade Conference were bound to support the Americans on all the main points, but no country was bound to act on the proposals unless and until they had

been embodied in a definitive international agreement, and ratified by enough major countries to make it practicable for the projected International Trade Organization to begin work.

The financial commitments, on the other hand, were quite unequivocal, and not the less binding because the Soviet Union and a number of other countries had not yet ratified the Bretton Woods Agreements. This fact, even with the American loan to ease the immediate situation, confronted Great Britain with a most formidable problem. For the first quarter of 1946, British export trade had reached 84 per cent. of the 1938 *value*; but in view of the change in prices this still left a very long way to go before the 1938 *volume* would be recovered, and an immense way before the 75 per cent. increase in volume regarded as necessary to meet the prospective deficit in the balance of payments could be achieved.

In the event, the International Trade Organization, for the creation of which the Americans had pressed so strongly at the outset, did not come into being. When the draft Charter for this body had been drawn up, the Americans themselves refused to ratify it, though it embodied many of the points which they had put forward in their original proposals. The fundamental reason for its rejection by the Americans is not far to seek. In the course of the discussions it had soon become clear that acceptance of the Charter by Great Britain and by a number of other countries would depend on the proposals relating to the conduct of international trade being fully complemented by clauses committing the signatory Governments to accept the responsibility of maintaining full employment. Countries which felt themselves to be subject to the threat of having their economies upset by the ups and downs of American economic activity could not afford to divest themselves of the power to protect themselves against these influences, should need arise, by trade measures which the Charter was designed to outlaw. But the American Congress, on its side, was by no means prepared to bind itself by international obligations to take the steps necessary for the maintenance of full employment, or even to allow American tariff and commercial policy to become subject to regulation by an international authority. Congress had indeed given the President power by executive act to make, on a strictly reciprocal basis, modifications in the United States tariff; but these powers were given only for a limited period and required frequent renewal by Congress, in which they were always under fire by business pressure groups. There was no assurance that Congress might not, at any time, take away the

powers conferred on the President and insist on a return to higher protection; nor was Congress prepared to have its powers to assist American producers in other ways—e.g. by farm subsidies—made subject to any sort of international review. The American Government, especially as long as Cordell Hull remained at the State Department, was genuinely in favour of reduced protection, as well as of a world trade structure based on the principles of 'no discrimination' and full convertibility of currencies. But the American Congress, even with the Democrats in power, did not share Cordell Hull's liberal capitalist conceptions. It remained, in relation to American interests, protectionist and nationalist in outlook.

The American Government had therefore to proceed with its plans as far as it could without asking Congress to enter into any long-time commitments. This meant jettisoning the proposed International Trade Charter, of which it had been the principal proponent. A definite announcement was made that the Charter would not be submitted to Congress for ratification; and that meant that the entire project lapsed, for no other country wished to proceed without American participation. The American Government then fell back upon a second line of action. While the Charter was under debate, attempts were already being made to negotiate an interim arrangement for the regulation of international trade during the period that was bound to elapse before it could come into force. Out of these negotiations arose the Geneva General Agreement on Trade and Tariffs, commonly known as GATT. This was intended in the first instance to be only an interim arrangement, to run until 1954; but when the proposed International Trade Organization fell to the ground, GATT in effect took its place, though still on a temporary footing. At a sequence of conferences held under GATT's auspices, the signatory countries negotiated a long series of mutual tariff concessions, mainly by bilateral bargains; but as the principle of the 'Most Favoured Nation Clause' was embodied in GATT itself, all these concessions were automatically extended to other signatory States. The President of the United States was able to use the temporary powers conferred on him by Congress to make reciprocal tariff concessions under GATT, but without any assurances that they would be continued beyond the period for which his powers had been conferred. Within these limits, GATT did achieve a not inconsiderable modification of tariffs, though not nearly enough to open the American market to exports from the debtor countries on the scale required to remove the scarcity of dollars.

GATT, however, was much more than an agency for negotiating mutual tariff reductions. The Americans succeeded in writing into it most of the proposals which they had put forward in their original plan for ITO; and the countries which signed it entered into extensive obligations in respect of trade policy. Among the requirements was one which applied particularly to Great Britain. Under GATT, existing Commonwealth preferences were allowed to remain in being; but Great Britain bound itself not to increase any existing preference and not to introduce any new one. There were comprehensive provisions in GATT forbidding trade 'discrimination' and applying this prohibition to state trading agencies as well as to States themselves. Quantitative regulation of imports, by means of quotas or licences or in other forms, was also outlawed. There were, however, both transitional provisions which allowed countries to maintain quotas or licences (provided they were non-discriminatory) for the purpose of protecting their balances of payments; and also 'escape' clauses, which allowed countries to give protection to industries threatened by 'dumping' of imports or even to industries seriously affected by the competition of imports that could not be regarded as 'dumped'. The exceptions were thus substantial; but the entire agreement was drafted on the assumption that most of them would last only a short time; and the signatory States were pledged not to continue them longer, or to a greater extent, than was absolutely necessary for the purposes for which they were allowed.

The entire agreement was concluded in the first instance for only three years from 1947-48. It was then supposed that by 1950-51 it would be superseded by the International Trade Charter. But by that time it was becoming clear, in face of growing opposition from American business interests, that the Charter would not be ratified. GATT was then continued for another three years, which were due to end in 1954.

American participation in GATT depends, as we saw, on the special powers granted by Congress to the President, which now need regular renewal. In 1953 the Republican-controlled Congress set up a special body to report by the middle of 1954 on the whole question of future trade policy. The continuance of the tariff concessions granted through GATT, and of American participation in GATT itself, depends on the decisions that will be taken in the light of this report. As for the other signatories, there are divided opinions about the future. The admission of Western Germany has caused

some misgivings; and much more serious fears were aroused in the summer of 1953 by Japan's application for membership of GATT. Japan, if admitted, would of course get the benefit of the 'Most Favoured Nation' provisions; but a number of countries, headed by Great Britain, were most unwilling to allow Japanese competition with their industries on these terms, especially in their colonial markets. The Australians and New Zealanders were also strongly hostile to Japan's admission to GATT. The charge against Japan was that its low-wage products would flood certain markets to the grave damage of European exporters; and it was even proposed that Japan should be excluded from the 'Most Favoured Nation' treatment which all the present signatories are pledged to observe, and should be admitted only to a restricted membership. It is, however, very much a moot point whether European or other powers which have colonial possessions have any right to deprive the peoples of such areas—who are themselves mostly very poor—of the right to buy cheap Japanese goods produced by workers whose standards of living are certainly no lower than their own.

In the event, at the GATT Conference held in the autumn of 1953, the existing provisions of the Agreement were extended for a further period, in order to allow the whole structure to be reconsidered when the Americans had decided what their future trade policy was to be. Japan, in face of British opposition, was allowed to become a sort of 'half-member' for the time being. Such countries as were prepared to enter into trade negotiations with the Japanese were to do so, on the principle that any concessions made to one country would be extended to all others that agreed to negotiate in accordance with 'Most Favoured Nation' terms; but any country belonging to GATT was to be free not to negotiate with Japan, and the Japanese were to be free to discriminate against the exports of such countries. At the same Conference, Great Britain secured a minor concession in respect of Commonwealth preferences; it was allowed to put import duties on certain seasonal agricultural products from foreign countries without imposing similar duties on products of Commonwealth countries, subject to the concession not being used to displace foreign by Commonwealth imports. As the goods in question came hardly at all from the Commonwealth, and as the purpose of the British demand was to protect British farmers, the proviso was not at all onerous. The need for the British request to GATT arose only because, under the general terms of the Agreement, no new Commonwealth preferences are allowed, and because

Great Britain was precluded by promises to the Dominions from imposing tariffs on Commonwealth agricultural produce. In general, then, the GATT Conference merely extended the existing arrangements for a further interim period, and, under American pressure, brought Japan into the scheme on a provisional footing.

Both in view of the uncertainty about future American policy and on more general grounds, the entire future of GATT is uncertain because its main structure rests on the assumption that the post-war disequilibrium in the world's balances of payments is merely temporary, and that the exceptions to the full rigour of the policy embodied in its main provisions will speedily disappear. It could, no doubt, be renewed for further periods, with some modifications, if the United States were prepared to go on; but it would evidently be quite out of the question, for a long time to come, to dispense with the exceptions—even if the will to do this existed, as it certainly does not.

It needs to be stressed that, whereas the main provisions of GATT, practically dictated by the United States, are extremely severe against all forms both of quantitative trade regulation and of discrimination between country and country in respect of imports, they leave open those kinds of restriction and discrimination which find favour with American business. Thus, shipping subsidies are not regulated at all; and it is left open to impose import restrictions or to grant subsidies for the protection of agricultural producers. GATT is very much an American-inspired document, which other countries have accepted under American pressure and in order to get the benefit of American tariff concessions. Its one-sidedness has not, however, prevented it from being strongly attacked in the United States as limiting American economic sovereignty, as making too many concessions to other countries in its temporary provisions, and as accepting the legitimacy of state trading (despite the great restrictions on such trading which it lays down).

We can now come back to the more purely monetary aspects of the development after 1945 of the policies endorsed at Bretton Woods. About the actual working of the International Monetary Fund, which began operations at the end of 1945 with an initial capital of $8,800 millions, there is not a great deal to say. It fulfilled in a modest fashion its first function of starting the member countries off with a supply of international purchasing power; but the manifest inadequacy of the sums thus made available, especially in face of the increase in prices and the changes in the 'terms of trade'

after 1945,* left it with no means of exerting a major influence on the course of events. It was soon realized that the size of the dollar gap and the prospect of its persistence had been fantastically underestimated; and the main part in bridging it for the time being was taken first by the United States and Canadian Loans to Great Britain in 1946 and then, after their speedy exhaustion, by Marshall Aid. The second function of the I.M.F. had been to bring the countries which set it up at Bretton Woods back to a system of convertible currencies on a gold foundation. But this, as we have seen, implied balanced exchanges and a wide freedom to buy and sell across national frontiers. Such freedom remained out of the question in face of the fact that convertibility would have meant a universal rush for dollars to buy American goods, and that such a rush could have been countered only by imposing the most severe quantitative restrictions on imports and by building up a gigantic system of bilateral trade bargains directly contrary to the principles of trade liberalization to which the signatory countries were committed.

There are, indeed, three ways—and only three—in which a country that is experiencing pressure on its exchanges can act to relieve the pressure. It can deflate: it can control currency transactions; and it can restrict imports by high tariffs and quantitative controls. Deflation, carried to sufficient lengths, destroys the excess demands for foreign currency by reducing the demands for imports as well as by increasing the currency's purchasing power through lower prices. But it also creates widespread unemployment, and requires reductions in wages and in other incomes as well as in public expenditure. In the situation which existed after 1945, no major country could face deflation on the required scale: it would have meant an intense social struggle and would have brought down any Government which attempted it in any country in which the Labour movement was a powerful force. The I.M.F.—and the Americans who were its main financiers—had to recognize this fact.

One great reason why deflation on the scale that would have been needed in order to eliminate excess demand was utterly out of the question was that, after 1947, there was a constantly increasing pressure on the countries of Western Europe to re-arm. Whatever was spent on armaments had to come out of the general pool of purchasing power: so that re-armament constituted an additional source of demand which aggravated the inflationary tendencies

* See page 96.

already present in the economies of the countries concerned. The Americans, who were pressing intensive re-armament on their partners in the North Atlantic Treaty, could not, while they were thus burdening them, also insist on the deflationary measures which they had favoured in 1944. Re-armament had to be done at the expense of either consumption or investment, or both. In practice, it necessarily involved large cuts in investment in non-war industries, and thus slowed down economic recovery and worsened the capacity of European in comparison with American production. It involved also cuts in consumption, especially in face of the rising cost of imported foodstuffs and materials in terms of manufactured goods. But, although both investment and consumption had to be curtailed, this was not achieved without adding to the inflationary pressure. Countries cannot at one and the same time consume more (if only to supply rising populations), invest more in re-fashioning their productive structures, and re-arm intensively—and, as in the case of France and Great Britain, carry on expensive colonial wars. Or rather, they cannot do this unless they have immense unused resources which they can tap. Even the United States was not immune from the inflationary pressure which the attempt to do all these things at once involved. For Great Britain and for France the consequences were a great deal worse, because the additional burden of re-armament was imposed on their economies at a time when they needed high investment and had by no means recovered from the adverse effects of the war.

Deflation, then, was impracticable, as well as undesirable—for it would have been ridiculous to enforce widespread unemployment at a time when every ounce of possible output was urgently needed. That left only currency regulation and direct regulation of trade as means of coping with the excess demand for dollars, as far as it was not met by the Loan or subsequently by American aid. Under the conditions which existed, and persisted, after 1945, both these methods had to be used; and it became evident that any big move towards liberalization of trade policies in the deficit countries was likely to lead to a crisis that could be dealt with only by making currency controls more stringent, and also that any move towards greater convertibility of currencies was liable to lead to a situation that could be coped with only by imposing stricter import controls. The Americans had wished to advance simultaneously towards the freeing of trade and towards the restoration of freely exchangeable currencies; but it soon became clear that, as long as the fundamental

disequilibrium remained, these two aims could not be pursued at once, and that the more there was of either, the less could there be of the other.

In these circumstances, the I.M.F. could play no major role. But the Americans were exceedingly reluctant to admit the inconsistency of their two objectives, and continued to press at both points. When Marshall Aid was introduced they hoped that the very large sums they were giving away would serve not only to balance the international accounts for the time being but also to enable the aided countries to set their houses in order by increasing production enough to escape from their deficit position. What this optimistic view left out of account was that, however much production increased in Europe, the dollar shortage would remain unless American purchases of the goods which the European countries could produce rose enough to give these countries a sufficient supply of dollars. No doubt, the Americans argued that the European countries could, by increasing their sales of manufactured goods to the countries producing primary products, get from these latter the dollars they earned by selling raw materials to the United States. But, save for a brief stockpiling spree after the outbreak of the Korean crisis, the dollars made available through such American purchases were not enough. The countries which got them wished to spend a substantial part of them on dollar purchases for themselves; and when the buying spree did lift them temporarily to a very high level, the effect was to raise the prices of raw materials—including those which had to be paid for in dollars—to heights which reacted very seriously on the economies of the deficit countries, and made the disequilibrium worse than ever. When, realizing this, the Americans moderated their buying, and the prices of most materials fell back to a much lower level, there was an easing of the immediate situation, but the basic disequilibrium remained. The countries which had benefited by Marshall Aid did in most cases improve their total balances of payments as their production increased; but the shortage of dollars persisted, and had to be met by continued control both over the exchanges and over the importation of goods from the dollar area. In fact, this latter control, which had been made much more stringent during the crisis, remained even at the end of 1953 more severe than it had been before the crisis of 1951.

Indeed, the rash attempt by Great Britain in 1947 to make sterling freely convertible had clearly shown the strength of the latent demand for dollars. No sooner was sterling made convertible, in

accordance with the terms that had been laid down by the Americans at the time of the Loan, than there was a rush to convert sterling into dollars. This rush, which began with demands from those who wished to buy dollar goods, was soon turned into a torrent by speculators who expected a devaluation of the British currency; and Great Britain had hastily to abandon convertibility and return to strict exchange control. This crisis was followed by the introduction of Marshall Aid, which took the form of a large grant of dollars to be shared out among the European recipients in proportion to their estimated balance of payments deficits. To administer the aid and to arrange the allocations, two bodies were set up—one, the European Co-operation Administration, by the Americans, as an entirely American affair, and the other, the Organization for European Economic Co-operation, by the States that were to receive the aid. This latter body began by agreeing on figures for the imports required by the European countries, first for 1948-49 and then for the subsequent years, and by estimating the value of the exports that would be available for paying for these imports. The deficit—that is, the difference between the two figures—was to be met by American aid to each country according to its prospective need. The European recipients asked to be allowed to use some of the dollars they were to get for making purchases in Europe, in order to cope with deficits arising in intra-European trade. But the American Act did not allow this. The need was, however, recognized to increase intra-European trade as a means both of maximizing European production and of reducing the need for dollars; and accordingly O.E.E.C. set to work to devise a payments scheme under which those European countries which were expected to export more to other countries in Europe than they imported from those countries were to extend credits to the prospective debtors. Into this scheme the sterling area, having a common currency system, had to enter as a unit. The question then arose whether these credits—known as 'drawing rights'—could be made transferable from one European participant to another—so that, for example, France, the biggest prospective intra-European debtor, if it did not wish to use all its sterling credit in buying British goods, could transfer part of it to, say, Belgium. The British Government had to reject this proposal because it had a payments agreement with Belgium under which, if the Belgian holding of sterling rose beyond a certain figure, Belgium could demand payment of the excess in gold. If other countries had transferred their drawing rights to the Belgians, Great

Britain might have been faced with claims for gold which it would not have been able to meet. The Americans pressed the British to accept transferability; but the answer was that, if it were insisted on, Great Britain would have to reduce considerably the total credits it had agreed to grant to other European countries—which amounted to £282 millions. The fear of this reduction led other European countries to withdraw the demand for transferability; and in October 1948 an agreed European Payments Plan, without this provision, was introduced, at first for an experimental period of one year. Within certain limits, drawing rights were subsequently made transferable, but only to countries whose payments were in deficit, for the purpose of meeting the deficit, and not to countries which were net creditors under the plan.

These arrangements did not cancel the numerous bilateral currency agreements into which European countries had entered before it came into force: nor did it prevent the conclusion of further arrangements. In 1950, for example, Great Britain entered into a special agreement for liberalization of payments with the three Scandinavian countries. Under the European Payments Plan, which continued until 1950, each country made out at the end of each month a statement of the sums owing to it from or owed by it to each other country, and passed this statement on to the Bank for International Settlements,* which administered the scheme. The B.I.S. thereupon did what it could to cancel debits against credits, not only for pairs of countries, but also by what was called 'multilateral compensation'. This meant—to take a much simplified example—that where country A owed money to country B, which owed money to country C, which in turn owed money to country A, these debts, if they balanced, could be cancelled so as to avoid actual payments. What debts remained after this process had been gone through were dealt with by making use of the 'drawing rights' which each country had agreed to grant to each other—with the proviso that a country which found itself holding more of the currency of another country than it had agreed to hold could demand payment of the excess in gold or dollars.

This system, amended in detail from time to time, was carried on until 1950, when it was superseded by the more developed arrangement known as the European Payments Union, which is still in

* The B.I.S. was originally set up to handle the transfer of reparations from Germany under the Young Plan of 1929. It is quite separate from the new International Bank established at Bretton Woods.

force as I write.* E.P.U. replaces the complicated earlier clearing system by one of fully multilateral clearing, made possible by the provision of an initial capital fund of $350 millions by the United States. Under E.P.U., which keeps its accounts in 'units of account' equal to U.S. dollars, the monthly clearing remains. But instead of reckoning each country's account with each other separately, E.P.U. lumps them all together, leaving each country with a net credit or debit balance to be settled. As in the Bretton Woods scheme, each participant country is given a 'quota', based in this case on the value of its trade in 1949. The quotas total $4,126 millions, of which the United Kingdom (representing the whole sterling area) has $1,060 millions or roughly a quarter of the whole. Any country which, taking into account all its E.P.U. transactions since the scheme began, has a credit balance, has to leave this balance, up to 20 per cent. of its total quota, on deposit with the E.P.U., which pays interest on it. If its credit exceeds this 20 per cent., half the excess remains on deposit with E.P.U. and the rest is paid to it in gold. If the surplus rises above 100 per cent. of the country's quota, special arrangements have to be made for dealing with it.

Countries with a debit balance were originally allowed full credit, on which they paid interest, up to 20 per cent. of their quotas; but the amount thus allowed was later reduced to 10 per cent. On debits over 10 per cent. of its quota, a country has to pay part in gold or dollars, on a rising scale as the debit increases. Up to 20 per cent., the gold payment is only one-fifth of the excess over 10 per cent.: at 100 per cent. of the quota, it increases to seven-tenths on the final 20 per cent., making a total payment of 40 per cent. in gold or dollars, with the remaining 60 per cent. of the debit allowed as a credit from E.P.U. The credits and debits here referred to are related, not to a member's transactions during a single month, but to its cumulative creditor or debtor position since E.P.U. began. As the relative position of the various countries changes a great deal from time to time, this means that gold is being continually transferred

* It has been renewed on an amended basis for 1954-55. Under the amended plan, Great Britain, as a debtor, has undertaken to repay at once in gold one-quarter of its total debt of £175 millions to the creditor countries and to pay off the rest by instalments spread over the next seven years. Other debtor countries are also arranging to repay their creditors, and E.P.U. is providing $130 millions out of its own resources for paying off the creditor countries. Fresh credits will then be made available to the countries that need them; but in future, with some exceptions, each debtor country will have to settle half of its monthly deficit in gold, receiving the other half as a credit from E.P.U.

from one to another. Great Britain, for example, became a large creditor during the period when European countries were making large purchases of sterling area materials at high prices, but soon lost the gold it had gained when the prices collapsed. The most persistent creditor country has been Belgium, for which special arrangements have had to be made in order to prevent a breakdown of the scheme.

E.P.U., backed by the Americans despite their dislike of limited arrangements for convertibility and their desire to get back to a

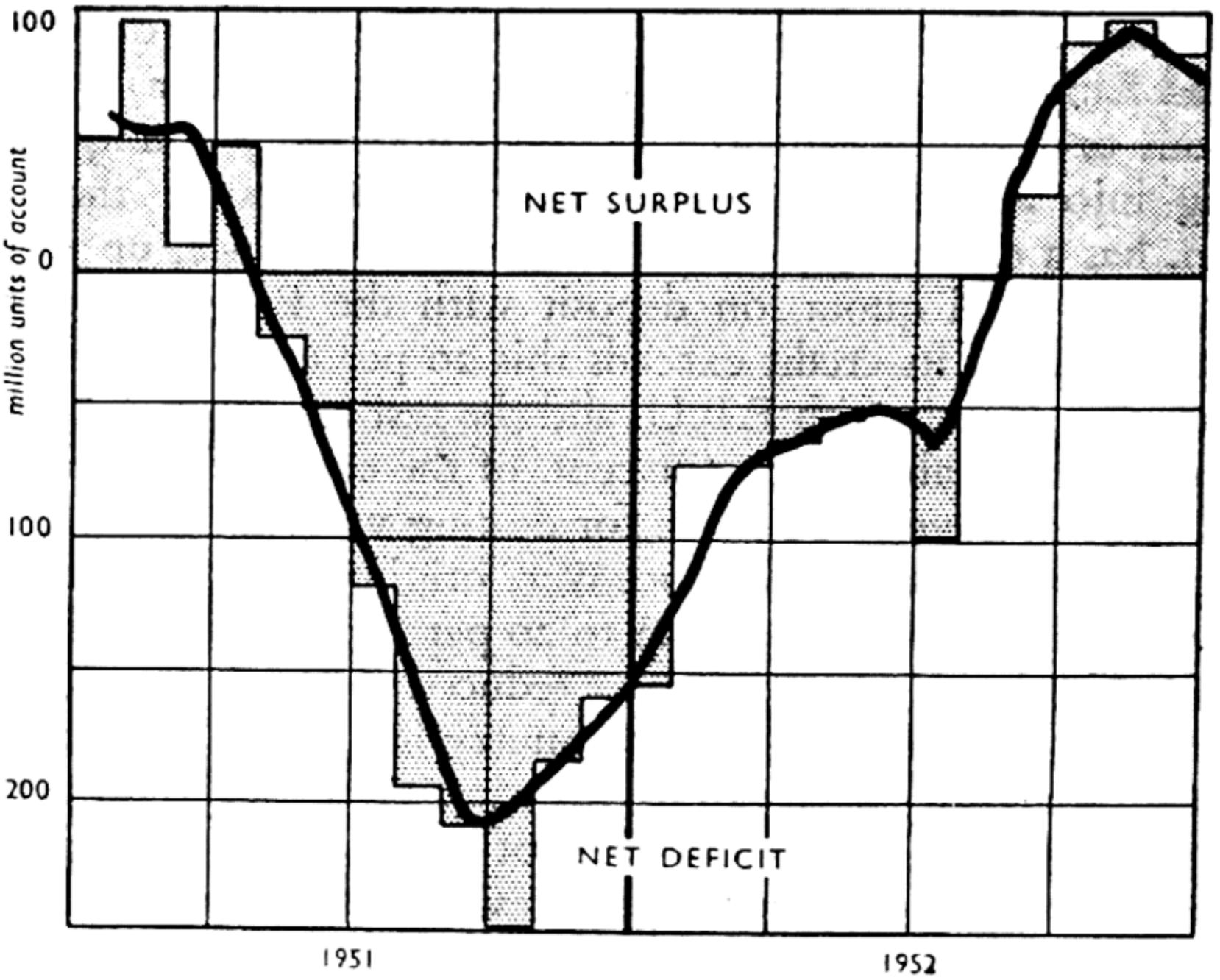

CHART II

European Payments Union, Monthly Position 1951-52
Sterling Area

fully international currency system, had a considerable effect in its earlier stages in stimulating intra-European trade and also trade between continental Europe and the sterling area. But it offers no solution of the dollar problem: it does nothing to prevent dollars from being scarce save to the extent to which it directs demand from dollar goods to goods produced in Europe or in the sterling area. That it did achieve some diversion of this sort is certain; but that did not prevent the dollar shortage from remaining acute, despite American aid. The European countries, including Great Britain, continue to need far more goods that have to be paid for in

gold or dollars than they can cover by sales of exports to the dollar area. Nevertheless, within its limited scope, E.P.U. has undoubtedly been useful: it could not, however, prevent most countries from having to cut down their imports from one another as well as from the United States in the crisis of 1951, for they could not afford to

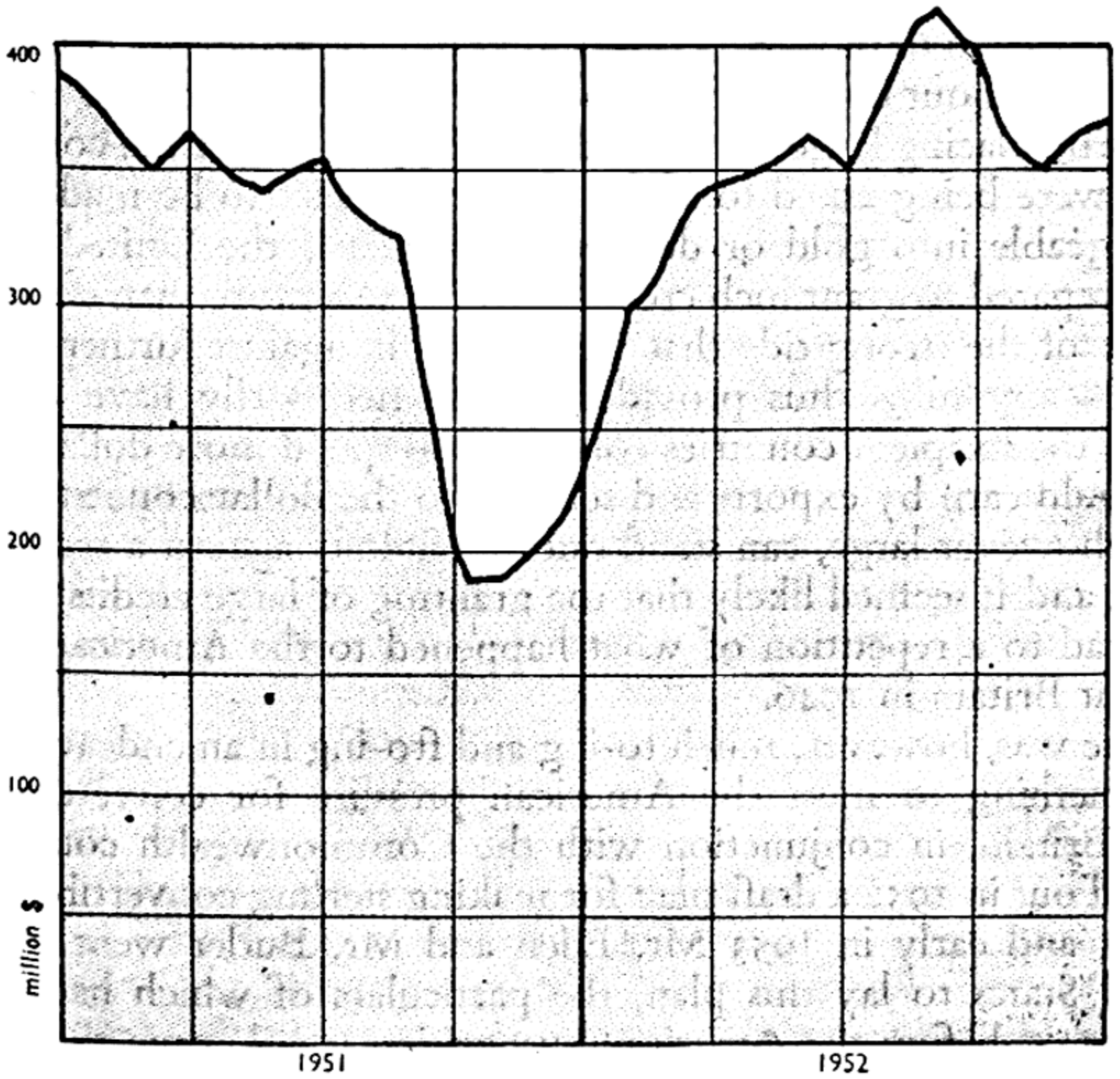

CHART III

European Payments Union, Cumulative Position of United Kingdom, 1951-52

run deficits of which a substantial fraction would have had to be settled in gold or dollars. The diagrams on these pages illustrate the sharp fluctuations which occurred in the position of the sterling area in E.P.U. in 1951 and 1952, and the effects on E.P.U.'s gold and dollar reserves.

The Americans were induced to support E.P.U. because they hoped that it might serve not only as a stimulus to European production and mutual trade, but also as a step towards full convertibility of European currencies with the dollar. They thus gave up,

for the time being, their hostility to the sterling area as a regional grouping which stood in the way of full convertibility and recognized the impracticability, as matters stood, of freeing the exchanges from control. They continued, however, to urge the need for full convertibility at the earliest possible moment; and since 1952 the practicability of such a step has been much canvassed. It was by this time plain, even to most Americans, that full convertibility could not be brought about unless the United States were prepared to underwrite it by placing large dollar credits at the disposal of the countries which were being asked to allow their currencies to be made fully exchangeable into gold or dollars. But, even if the United States were prepared to grant such credits—which was more than doubtful in view of the strong tide that was setting in against further aid to Europe—any sums thus provided would necessarily have melted away if the recipient countries continued to spend more dollars than they could earn by exports and services to the dollar countries. No credit, however large, can stand out indefinitely against a recurring deficit; and it seemed likely that the granting of large credits would only lead to a repetition of what happened to the American Loan to Great Britain in 1946.

There was, however, much to-ing and fro-ing in an endeavour to do something to meet the American pressure for convertibility. Great Britain, in conjunction with the Commonwealth countries, worked out in 1952 a draft plan for making sterling convertible into dollars; and early in 1953 Mr. Eden and Mr. Butler went to the United States to lay this plan, the particulars of which had been kept secret, before the American authorities. It is known that they insisted, as an essential part of any plan for restoring convertibility, that creditor countries—that is, above all the United States—would have to take steps, by admitting more imports—manufactures as well as materials—to restore the balance of trade, as the accompaniment to steps to be taken by the debtor countries to reduce the pressure of demand for dollar goods—presumably by deflation. They also insisted that convertibility should not be brought about in such a way as to strangle intra-European trade or trade between Europe and the sterling area by compelling countries to impose still more drastic restrictions on imports. They further required special measures for the strengthening of European gold reserves, and apparently suggested that the International Monetary Fund should be re-animated with fresh resources in order to put the participating countries back into credit.

To these overtures the Americans gave an entirely discouraging reply. Further decisions on United States commercial policy were deferred, as we have seen, until after reports had been prepared for Congress in 1954: nor was there any readiness to act on the suggestion that the United States should allocate large sums to underwriting the currencies of Europe. When, in March 1953, Mr. Butler reported to O.E.E.C. on his American visit, it was made plain that the entire project had collapsed.

This failure led to a change of emphasis in immediate British and European policy. The Commonwealth Conference of 1952 had appeared to give priority to the problem of sterling convertibility over that of liberalizing the conditions of trade by loosening the restrictions on imports. But when the Americans failed to respond to the Commonwealth overtures, there was a tendency to give priority to measures for the expansion of trade, especially within the E.P.U. area, as against convertibility, which had to be dismissed as impracticable for the time being. A number of import restrictions were relaxed by Great Britain, Australia, and some other countries though not by enough even to bring the openings for trade back to the point they had reached before the crisis of 1951.

Meanwhile, in January 1954, the Randall Commission on Foreign Economic Policy, appointed jointly by the American President and Congress the previous year, made its report. It began with a pæan of praise for the dynamic, resilient creativeness of the American economy and with an insistence that it must continue to be based on 'the freest possible opportunity for the development of individual talents and initiative in the utilization of private resources and through the free association of workers'. It referred to the substantial economic progress made by European countries both in production and in the liberalization of trade, but held that this progress had not yet come within sight of solving the dollar problem. It stressed the size of the American disbursements that were still contributing to the balances of payments of the countries of Europe, and the existence of a 'concealed dollar gap' that would at once appear if these payments were withdrawn. It put this gap at from $2 to $3 billion, after allowing for annual gold imports of $2 billion. It then went on to recommend discontinuance of economic, but continuance of military, aid, the continuance of Technical Assistance within the limits of Congress appropriations, the encouragement of private foreign investment, subject to its 'fair treatment' by the recipient countries (and therewith a discouragement of public loans), the

modification of United States farm policies and the possible termination of the International Wheat Agreement, the amendment of the 'Buy American' Act and of other Acts giving special preference to American business, the simplification of tariff schedules and methods of valuation, changes in the administration of the 'anti-dumping' law, the maintenance of United States opposition to trade discrimination, the amendment of GATT in the direction of fuller multilateralism, the extension for not less than three years of the President's existing powers to negotiate reciprocal tariff reductions, and an extension of these powers beyond their existing limits. Finally, the Randall Commission recorded its view that 'convertible currencies constitute an indispensable condition for the attainment of worldwide multilateral trade and the maintenance of balanced trade in a relatively free market', but at the same time recognized the difficulties in the way of full convertibility and said that it would 'deplore a merely formal convertibility maintained through trade restrictions'. It then issued a warning against rushing other countries into convertibility until there was a reasonable prospect of their being able to sustain it without resorting to the controls over trade and the exchanges of which the Report hoped to dispose.

The Randall Report, even if it had been adopted in full, would not have cured the dollar shortage or produced an expansion of United States imports on a scale sufficient to restore equilibrium. But the test was not to be made. The Report was at once strongly attacked in America by a powerful group of vested interests hostile to any decrease in protectionist policies, and to any increase in the President's powers to negotiate tariff bargains. In face of the growing opposition to it within the Republican Party, President Eisenhower first announced that action on its recommendations could not be taken in 1954, and later abandoned the hope even of getting at present an extension for more than a single year of his powers of reciprocal tariff bargaining.

It is true that, since Great Britain's gold and dollar reserves sank to the low point of £594 millions in April 1952, there has been a large recovery, which brought them up to more than £1,000 millions in April 1954, despite the decline in Defence Aid from the United States. In 1953 and 1954 sterling was once more a 'strong' currency, and was maintaining its position well without the need for outside help. Some part of the rise in the gold and dollar reserves was undoubtedly due to sterling's very strength, which had attracted foreign funds to London; but the greater part of it was the outcome

of successful trading by the countries of the sterling area, including the primary producing areas as well as Great Britain. It would, however, be unwise to build too much on this recovery, real though it has been. Even in April 1954 total gold and dollar reserves were still below the level reached towards the end of 1950, before the Korean crisis had carried them to their highest point in June 1951. They were still not nearly large enough to stand any prolonged strain.

Nevertheless, during the early months of 1954 there was much renewed talk about the return to convertibility, for which, in E.P.U., the Germans and the Belgians were strongly pressing. When the Chancellor of the Exchequer visited Bonn in the spring of that year in connection with the negotiations over the extension of E.P.U., it was widely reported that Great Britain intended to make sterling convertible into dollars by the autumn. It is, however, clear that Mr. Butler, if he gave any undertaking, had in mind something a long way short of the full convertibility for which the Americans have been asking. The most that seems at all likely to be practicable is a concession which would allow convertibility of foreign-owned sterling earned in the course of current transactions, without any right for British owners of sterling to convert it without special permission.

Such an arrangement would leave accumulated sterling balances still unconvertible except by special arrangement, and would not allow British owners of sterling to convert it into dollars any more than they can at present. It would, however, open a quite wide door to the use by foreigners of currently earned sterling for making dollar purchases: whether the finances of the sterling area are yet strong enough to stand this strain I do not pretend to know. I do, however, feel sure that no one can reasonably predict that, even if, in the circumstances of 1954, the strain could be borne for the time being, there can be any assurance that it can be so permanently, irrespective of what happens to the American economy in the future. I therefore regard the prospect of even this limited form of convertibility being attempted with serious misgivings; and I am altogether opposed to it in any form that would involve a promise to maintain it should the strain prove at any future time to be too great.

Thus, even in 1954, the dollar shortage still remained an unsolved problem. The achievement of the deficit countries in improving their productivity, developing mutual trade, and reducing their dependence on dollar imports had hardly done more than keep pace with the reduction in American aid, which, even in its military

form, the United States was threatening to bring to a speedy end. Nor was there any sign that the gap was likely to be filled either by a drastic change in the American tariff or by the growth of American overseas investment to dimensions capable of offsetting the deficiency in the power of other countries to buy American goods.

This brings us to the second of the agencies set up under the Bretton Woods Agreement—the International Bank for Reconstruction and Development, which has its headquarters in the United States and operates under an American President. This bank was designed, as we have seen, to stimulate investment in countries in need of foreign capital, not only by making loans itself, but also by inducing private investors to come forward. It is expressly precluded by its statute from lending money which the borrowers could obtain elsewhere on reasonable terms; and in general it lends only money needed by the borrowers for making purchases abroad, and not money to be spent on buying labour or commodities within the borrowing country. It is essentially a provider of foreign exchange for use in making capital purchases, and not an agency for financing development projects which countries can undertake out of their own physical resources.

The I.B.R.D. began its operations in 1946 and made its first loans in 1947. At the outset it lent mainly to countries in Europe which needed to buy equipment from abroad—chiefly from the United States—for the reconstruction of their war-shattered economies. But when Marshall Aid began to operate early in 1948 the Bank largely withdrew from Western Europe and made most of its loans to Latin America, India and Pakistan, Australia, and other countries outside Europe. Most of its loans, though by no means all, have been made either to Governments or to other public bodies; and the greater part of them has been spent on the development of public utilities—especially electric power station and railway construction. The loans are made, not in gold or in any one currency, but usually in the particular currencies needed by the borrowers for buying the capital goods they require; and they are usually tied to particular projects and subject to supervision of the expenditure by the Bank. In a considerable number of cases the Bank, as a preliminary to considering loans, has sent expert missions to the countries which have asked for money, and these missions have made general reports on the economic position and prospects of the countries concerned and have advised them about the development plans most likely to meet with the Bank's approval. These missions have reported not

only on projects which the Bank has been asked to finance, but also on the openings for private investment in the various countries and on the means of developing local capital markets and locally produced materials and equipment. They have also given often unpalatable advice to under-developed countries against ambitious projects which exceed what these countries can immediately afford.*

The Bank for Reconstruction and Development is not a philanthropic institution but a business concern. It aims at making a profit, which it places in a reserve against losses. It therefore charges quite high interest rates—in 1953 its lending rate was $4\frac{7}{8}$ per cent. This rate is uniform for all business. It is based on the rate at which the I.B.R.D. itself can borrow in the open market, plus a charge for administration and a contribution to the reserve. Countries are thus deterred from borrowing rashly; but in addition the Bank itself has followed for the most part a very cautious policy. All its loans have to be guaranteed by the Governments or Central Banks of the borrowing countries, whether they are made to public bodies or to private concerns.

The Bank operates with a capital subscribed by its 54 member States according to a quota system based on each country's national income and international trade. Its nominal capital is $9,036 millions; but only one-fifth of this has been paid up, and the remainder is not meant to be called up unless it is needed to meet actual losses which cannot be met out of the Bank's accumulated reserves. It has thus only a relatively modest capital of its own; but it is empowered to borrow in the open market and has made bank issues not only in New York but also in Switzerland and London. A curious provision regulating the use of its own capital is that the sums subscribed by a member State can be used only with that State's consent for investment in a project of which it approves. Thus, Great Britain has consented to the use of a part of its quota for loans to Australia and other Commonwealth countries for particular development projects. In all, up to the end of 1952, the Bank had lent about $1,524 millions,† of which only $177 millions had been lent to private borrowers, the largest of these loans being $31,500,000 to the Indian Iron and Steel Company. Some of the government borrowings, however, had been in fact passed on to private concerns. Excluding the $500 millions of 'reconstruction' loans made to European

* Such a mission from the Bank had reported to British Guiana shortly before the suspension of the Constitution and the deposition of the Ministry there in 1953.

† By the end of 1953 the total had risen to $1,892 millions.

countries in 1947, which were for general purposes, the Bank had lent nearly $400 millions for electrical development, largely in Latin America; well over $200 millions for transport projects, chiefly for railway building in Asia and Africa; and about $150 millions for agriculture and forestry. This leaves rather more than $200 millions for all other loans: so that relatively little had gone into industrial development outside the fields of railways and electric power. In some cases the Bank has participated with private investors in making a loan, and in others, after lending money itself, it has sold the bonds to private concerns—usually with the Bank's guarantee behind them. Under American management, the Bank has been doing its best to foster private foreign investment, especially by American investors; but its success in this respect has been far too limited to make any substantial contribution to rectifying the disequilibrium in the balance of payments between the United States and the rest of the world.

The I.B.R.D. has been often accused of over-caution in its loan policy, and also of charging too high a rate of interest. It has indeed been able to build up very large reserves.* A slightly lower interest rate, however, would probably not have made a great deal of difference: the main factor restricting its operations has been its caution in approving projects, which is to a great extent the necessary outcome of the conditions laid down in its statute and of the general policy approved at Bretton Woods. It has been continually on guard not only against incurring losses itself, but also against doing anything that might give rise to inflationary consequences in the borrowing countries. When a country embarks on projects of capital development, a good deal of the money is usually paid out within its frontiers to workers employed in carrying out the tasks, to firms supplying materials, and sometimes, alas, in 'rakes-off' to local potentates and officials. These payments increase consumption in the country, and stimulate a demand for imports. The Bank, in refusing to provide finance for such expenditures, has been trying to compel the borrowing countries to raise the money needed for them either by taxation or by borrowing from their own citizens, so as to prevent an inflationary rise in consuming power; and its adherence to this policy has had a strong discouraging effect on potential borrowers. Accordingly, those who hoped that the Bank would have a large effect in stimulating rapid economic development in the backward countries have been disappointed. Doubtless, the Bank could have

* At the end of 1953 its total reserves exceeded $129 millions.

done a great deal more than it has actually done, by making greater use of its power to borrow from the investing public on its own guarantee of the money lent. But, had it done this, it would have been at once accused of unfair competition with private business, and of violating the terms of its statute, which forbade it to compete with the private investor or to advance money for projects which could be financed elsewhere. As long as it has to operate within these limits, it cannot become a major force in world development, which must depend mainly on the preparedness of private American investors to place their capital abroad on terms acceptable to the borrowing countries. This, under present circumstances, they are quite unlikely to do on a sufficient scale to make much impression on the general dollar shortage. No really big plan of world development designed to raise standards of production in the less developed countries is possible at present unless the United States Government is itself prepared to find most of the money for it and to allow this money to be used largely for buying, not American goods, but capital goods exported from the more advanced countries which are short of dollars.

When, in January 1949, President Truman made his 'Point Four' speech, in which he held out the hope of a great American programme of technical and economic aid to the less developed countries as the complement to the Marshall Aid given to Europe, large hopes were entertained that something of this order would be done. But Technical Aid turned out to be a quite small, though useful, affair of sending missions to help backward countries to improve their techniques, of helping with the vocational training needed for this purpose, and of supplying small quantities of equipment. This was good enough, as a preliminary step; but the hopes that it would be followed up by the grant of large capital sums for economic development were disappointed. The United States was not prepared to finance the Colombo Plan launched with high hopes in 1950 for the development of Southern Asia, or to become the financier of any other ambitious development plan. More and more, its willingness to provide funds came to be linked to the pursuit of the 'cold war' and to be restricted to 'mutual security' grants which were made conditional on heavy spending by the recipients out of their own resources on increased armaments; and by 1953 it looked as if even these grants were likely to be speedily contracted, if not entirely given up.

Thus, for the most part, the less developed countries were left to

depend on their own resources for financing capital expenditure designed to improve their productive power; and in face of their own balance of payments difficulties most of them had to cut down the projects they had been planning. The worldwide 'War on Want', which Lord Boyd-Orr advocated when he was Director of the Food and Agriculture Organization as the best way towards peace as well as towards prosperity, has faded out of men's vision; and, now that Marshall Aid too is at an end, the only sure way to American assistance is that of military subvention on condition of participation in the crusade against Communism in all its forms.

XIX

CONCLUSION

REFLECTION on the entire course of events since 1945 strongly suggests that the assumptions which lay behind the monetary and commercial policies worked out at Bretton Woods, at Havana, and at Geneva, were fundamentally at fault. The very notion of a single, unified monetary system, under which national currencies are to be freely convertible at fixed values, pre-supposes a tendency towards international economic balance which does not in fact exist. Even if the Soviet Union, Soviet China, and the other countries within their orbit are left out of account, there are in the Western World powerful forces making for unbalance which no amount of monetary manipulation and no regulation of trade conditions can remove. On the European side, the most important factors are, first, the burden of heavy expenditure on wars and armaments, superimposed on economies which are struggling with other serious difficulties, and secondly the change in the 'terms of trade', which has left imported materials and, to a less extent, foodstuffs considerably dearer in terms of exported manufactures. On the American side, the outstanding problem is that the industries of the United States, with a productivity far ahead of the European, have the capacity to export much more than the equivalent of the imports Americans are normally prepared to buy, and that this situation is aggravated by the creditor position of the United States, which requires other countries to export to it considerably more than they can afford to buy from it. It is true that when the Americans engage in a 'buying spree', as they did in 1951, a great outpouring of dollars results. But this, far from removing the difficulties of Western Europe, makes them worse, because the Americans buy chiefly raw materials, and their purchases force up the prices of these materials and adversely affect the balances of payments of the European countries. The benefit, no doubt, accrues temporarily to the countries which are the principal suppliers of the materials in question; but such windfalls do not last and can easily so upset conditions in the countries which receive them as to cause serious crisis when the Americans restrict their buying and the prices fall suddenly and catastrophically back towards their previous level. If the American demand were steady, the rest of the world could do something to

adjust itself to the dominant position of the United States in the world market; but it is in fact extremely fluctuating. Since the war, the balance of payments of the United States on merchandise and transport account has varied between surpluses of $10 billions in 1947 and $1·5 billions in 1950. Its commodity imports rose from $6,698 millions *f.o.b.* in 1949 to $11,070 millions in 1951, falling slightly to $10,812 millions in 1952. So far, total American imports have risen in value each year since the war, except in 1949 and 1952; but that has been because the United States economy has been expanding almost continuously. If this expansion were to be sustained, the chief danger to Europe would continue to be that the irregularity of its rate, *plus* the fluctuations in stockpiling policy, would render the prices of European imports entirely unpredictable and would thus lead to wild variations in the balances of payments, far beyond the power of such agencies as the International Monetary Fund to cope with. If, on the other hand, the United States were to undergo a sustained recession—even well short of a really serious slump—though the European countries would get the benefit of cheap imports, this would be far more than merely offset by the effects on European exports. Not only would the American market for European manufactures be sharply reduced: much more serious would be the fall in the purchasing power of the primary producing countries as a consequence of reduced American demand. The industrial countries would find their export markets cut off, and would be forced, in turn, to impose much more drastic restrictions on their imports. An American boom is bad enough for Europe, as was seen in 1951: an American slump would be infinitely worse.

This catastrophic impact of fluctuations in the United States economy on the rest of the world is largely the consequence of the small proportion which United States foreign trade, vast though it is, bears to total American production and consumption. With only a few exceptions, important in themselves but not enough to invalidate the generalization, foreign trade is marginal to the American economy. Any given amount of fluctuation in the American economy as a whole engenders a much greater degree of fluctuation in American trade with other countries. The protection accorded to American producers makes it possible for them to exclude competitive imports when their sales decline; and the first reaction to a threatened recession is to let stocks of materials run down, so as to reduce the demand for imported materials well below the rate at which they are being consumed. Other countries are helpless in face

of such fluctuations: they can neither force their goods into the American market nor sell them elsewhere in face of the reduced buying power of their usual customers. All they can do is to try to lessen the impact of American fluctuations on their economies by entering into mutual arrangements among themselves. But such arrangements cannot be improvised when a crisis has already occurred: they need to be made well in advance and on a quasi-permanent basis if they are to be effective. It is a matter of entering into arrangements for expanded trade, on as stable foundations as possible, between primary producing and industrial countries, on terms which will allow the trade to continue even if America restricts its buying; and this cannot be done except by means which involve both commercial discrimination and currency arrangements which exclude free convertibility of sterling and other European currencies into dollars.

It would be pleasant to believe that these conditions of price instability, sudden fluctuations in trade, and chronic scarcity of dollars are only the temporary pains through which Europe has to pass in the course of recovering from the mishaps of war. But all the evidence makes the other way. In an open world market, the demand for American products greatly exceeds the American demand for the products of other countries, even when the Americans force up the prices of their own imports by excessive buying. Consequently, if other currencies could be converted freely into dollars, there would be such a rush to convert them that the gold and dollar resources of the sterling area and of other European countries which are in deficit would vanish almost instantly, and that nothing the International Monetary Fund or the World Bank could do would avail to prevent a crisis, at the onset of which the first casualty would be convertibility itself.*

If this is accepted—and to show the inevitability of it has been a large part of the theme of this volume—what is to be done? Clearly, it would be entirely wrong to react to the opposite extreme and to argue that, as full internationalism will not work, the world ought to revert to economic nationalism instead. Such a policy would be disastrous, above all for Great Britain with its great dependence on overseas trade for the very means of life. Any country which practises economic nationalism must expect others to do the same; and Great Britain is particularly vulnerable to re-

* This, of course, is meant to refer to *full* convertibility. It would not necessarily apply to the restricted convertibility to which reference has been made on page 401.

strictive policies on the part of its regular customers. In a full sense, there is no remedy for the situation arising out of the economic predominance of the United States: there are only ways of rendering it less potentially disastrous. These ways are not the ways of economic nationalism: they call imperatively for regional and inter-regional co-operation—for the maintenance and development of the sterling area and of the European Payments Union and for an attempt to build upon these foundations a much closer trading and planning partnership. Neither Western Europe by itself nor the sterling area by itself is a viable unit. European industries are much more competitive than complementary; and the sterling area cannot dispose either of its primary products or of its manufactures within its own frontiers. Western Europe, *plus* the sterling area, comes much nearer —not to self-sufficiency, which is not required—but to viability, in the sense of being in a position both to enlarge mutual trade and to safeguard itself against the more catastrophic effects of American instability. The necessary monetary basis for such an area exists already, in the Sterling Area Pool and the E.P.U.; but the economic basis has still to be created—which it cannot be without a much larger advance towards collective planning and long-term bargaining for mutual exchanges of goods than has been attempted so far. Obviously the difficulties—political as well as economic—in the way of such concerted planning are very great. Immediately, the most formidable of all is that the European countries concerned cannot possibly tackle them as long as they are burdened with crippling costs for wars and armaments; for these costs make it sheerly impossible to undertake the large-scale investment which the development of European and sterling area production requires. Both for this reason and for others escape from dependence on American aid, which is now almost entirely conditional on high military expenditure, is essential. The United States will not go on financing Europe except on terms of armament spending which render the aid a net handicap—above all because it prevents economic rehabilitation and development.

Yet Europe has become in these latter years so dependent on American gift dollars that the loss of them is bound to lead to serious immediate difficulties. These difficulties would be, directly, much less formidable to Great Britain than to a number of other countries. Total American grants and loans to Great Britain amounted to about £154 millions in 1952 and to about £105 millions during 1953—less than 5 per cent. of the total cost of British imports. In respect of

current transactions (excluding capital movements and changes in gold and dollar reserves) Great Britain had a surplus of £255 millions in its total balance of payments in 1952 (partly as a result of de-stocking after the heavy purchases of 1951) and a surplus of about £225 millions in 1953. The loss of American aid, offset by a reduction in expenditure on armaments, would thus not be too formidable. But of course the total balance of payments is not all that matters. With the dollar area Great Britain had in 1952 a deficit of £172 millions, as against a favourable balance of £436 millions with the rest of the world. In 1953, however, the dollar deficit had been almost wiped out, after making allowance for American Defence Aid. Thus, since the serious restrictions put on dollar imports after the crisis, the British dollar deficit has ceased to be a big factor. But this is the case only because dollar purchases have been drastically cut: any considerable relaxation in this respect would at once cause the deficit to reappear.

The two countries which would find it hardest to dispense with dollars are France and Italy. France could not do so, unless it could at the same time completely solve its colonial problems; but if it could do that, the matter would be relatively simple. Italy, because of its poverty and its heavy load of unemployed man-power, is in a more difficult position: so is Greece. But, at any rate for France and Italy, continued dependence on a bounty that may be withdrawn at any moment cannot be comfortable. Both countries have much more to gain from a viable European economy than they can hope for from indefinite dependence. In France at any rate there are enough long-sighted persons who realize this to give ground for hope that there would be a response to a British initiative.

Great Britain, however, cannot give the lead that is needed while it continues to knuckle under to American pressure. It cannot, under present circumstances, even concert a common policy with the rest of the Commonwealth, with Canada usually throwing its weight on the side of the United States and with South Africa too outside the Sterling Area Pool. It is impracticable at one and the same time to coquet, under American and Canadian pressure, with projects for making sterling freely convertible into dollars and to take the lead in building up the widest possible monetary and commercial union between the sterling area and Western Europe. The two policies are fundamentally different: there is no practicable bridge from the one to the other.

Already, Great Britain's membership of E.P.U. covers the trade

of Western Europe with the rest of the sterling area. Within the limits of E.P.U., the European countries can use their sterling to buy materials from the primary producing countries and thus economize on dollar imports. This leaves Great Britain to recompense these countries with its own exports, and thus provides a sound, though limited, foundation for multilateral trade.

To-day, the Americans would no longer oppose a plan for linking the sterling area more closely to a more unified Western Europe. They might even encourage it, as they encouraged and helped the formation of the European Payments Union. But, even in helping it, they would wreck it, unless they were firmly held in check. In the first place, they would try to use it as a means of intensifying European re-armament, whereas its chances of success would depend on a diversion of resources from re-armament to economic development and reconstruction. Secondly, they would insist, as far as they could, on treating it as a transitional expedient on the way to full convertibility and no discrimination, whereas the essence of it is that it is a workable alternative to these policies. For the Americans, it is axiomatic that other currencies ought to be freely convertible into dollars and that preferential arrangements for mutual trading ought to be done away with as soon as possible. They refuse to regard the dollar shortage as more than a temporary obstacle, and remain sure that everything will come right if the rest of the world will but behave in soundly capitalist ways. They cannot see that creditors, fully as much as debtors, have obligations, and that their unwillingness to receive other countries' imports in payment is a fatal obstacle to the restoration of equilibrium to the international economy. This being the position, and with the United States Congress an irremovable obstacle to a change of attitude, other countries are left with no workable alternative to doing the best they can to insulate their combined economies from the devastating effects of dependence on the United States.

Let us suppose Great Britain ready to take the lead in a crusade for independence. What follows? Clearly, if a number of countries agree to take common action for the creation of a viable Sterling-E.P.U. group, each one of them must be prepared to accept the conditions of the co-operative effort. They must all oblige themselves not to resort to a *sauve qui peut* at one another's expense. They must all follow policies of the fullest possible employment; but they must also make war in common on inflationary tendencies. Each of them must bring down demand to correspond to the available

supply of goods and services, must establish and maintain realistic rates of exchange with the others, and must play its part in a broadly concerted plan both for the re-equipment and development of its own industries and for helping in higher productivity through planned investment in the less advanced areas. Within each country, and internationally, there must be strong enough controls to prevent projects nominally designed to promote expansion from being perverted into agencies of restrictive cartelization. Above all, those who devise and execute these co-operative plans must bear constantly in mind that they may at any moment be confronted with the temptation, in face of any serious American recession, or even merely of a sudden withdrawal of American aid, to scrap their common plans and to revert to economic nationalism as the easier policy in the short run, however disastrous it may be in the long. For, let me repeat, nothing that Western Europe or the sterling area can do can prevent an American depression from seriously upsetting the European and sterling area economies, if it comes before the long process of building up the economic defences of the new combined area has been carried through.

Some readers of this book will probably complain that I have devoted far too much of it to a consideration of what happened in the 1920s and 1930s, when deflation and unemployment were the great evils needing to be combated, and too little to the remedies for the opposite evils of inflation and excess demand. I have done this because nobody knows how soon we may again be facing these enemies of the inter-war period, especially if we remain as tied as we are now to the vicissitudes of the American economic system. Since 1945, it has been very necessary to hold inflationary forces under control, to take special measures to procure the setting aside of adequate resources for industrial investment, and to hold down consumption both by limiting imports and by restricting spendable incomes. But to-morrow we may find ourselves in the grip of forces that will bring about a deficiency of demand for both consumers' and investment goods, both in the domestic and in the overseas market. We need to stand ready, in such circumstances, to apply again the techniques that would have been appropriate in the 1930s, but to do so under much more difficult conditions, because we have no longer the means of 'living on our fat' by drawing on overseas investments. In order to keep our people at work, we shall have to import heavily from the sterling area and from Europe, and these areas will have to import heavily from us; and we shall have

to avoid the temptation to take full advantage of the fall in import prices that the reduction of American purchases will tend to bring about, for, if we do this, we shall only be destroying our own markets and spreading devastation further and further. Price stabilization—in the sense not of fixing prices absolutely but of limiting their fluctuations over a sufficient period—is an indispensable condition for the building up a viable unit including both primary producing and manufacturing countries. Yet it is evidently a difficult policy to implement.

Clearly, there is a long way to travel before we can hope to arrive at the viable 'third economy' and to make it strong enough to stand firmly on its own feet. But what is the alternative? To await inactively the devastation that will fall upon us with the first serious American depression, and in the meantime, by spending on armaments at American behest far more than we can afford, to render impossible the higher productivity which cannot be brought about without higher investment both in Europe and in the less developed countries whose fortunes are linked to ours.

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